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LEGISLATIVE PROGRAM REVIEW  
& INVESTIGATIONS COMMITTEE

**Connecticut  
Budget Process**

DECEMBER 2003

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**CONNECTICUT GENERAL ASSEMBLY  
LEGISLATIVE PROGRAM REVIEW AND INVESTIGATIONS COMMITTEE**

The Legislative Program Review and Investigations Committee is a joint, bipartisan, statutory committee of the Connecticut General Assembly. It was established in 1972 to evaluate the efficiency, effectiveness, and statutory compliance of selected state agencies and programs, recommending remedies where needed. In 1975, the General Assembly expanded the committee's function to include investigations, and during the 1977 session added responsibility for "sunset" (automatic program termination) performance reviews. The committee was given authority to raise and report bills in 1985.

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# Introduction

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## **Purpose of the Study**

The Legislative Program Review and Investigations Committee (LPR&IC) initiated a study of the state budget process in February 2003. The purpose of the study was to examine whether the practices followed by Connecticut in preparing the spending side of the General Fund budget optimize decision-making and are consistent with sound budget procedures.

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## **Scope and Methods**

Government budgeting encompasses executive and legislative activities related to the development, implementation, and evaluation of a plan for allocating resources to provide public programs, services, and capital assets. The committee's review of Connecticut's process centered on formulation of the state's operating budget. Key areas of analysis included:

- model procedures and best practices for preparing state budgets;
- compliance with statutory budget requirements; and
- the effectiveness of existing methods in developing a balanced, sustainable state budget.

The state's revenue structure and policies, while critical considerations during the budgeting process, were not examined in this study. The capital budgeting process was also excluded from the scope of the review.

In July 2003, the committee revised the study scope to add a second part focused on performance budgeting, using state workforce development programs as a case study. The main area of analysis was to try to determine the relationship between program outcomes and funding decisions.

Among the research methods employed by program review staff in carrying out the study were:

- an extensive literature review;
- analysis of relevant state statutes, policies, and guidelines;
- compilation of comparative state budget process information;

- interviews with budgeting experts and key participants in the Connecticut process including legislative leaders and members of the General Assembly's appropriations and finance committees; and
- interviews with staff from the Legislative Office of Fiscal Analysis and officials and staff from the Offices of Policy and Management (OPM), the State Comptroller (OSC) and the State Treasurer (OST).

The program review committee also held an informational public hearing on September 16, 2003, to receive comments about the state budget process. Testimony was provided by the state comptroller, the secretary of policy and management, and three advocacy groups (Advocates for Connecticut's Children and Youth, the Connecticut Conference of Municipalities, and the National Association of Social Workers/Connecticut Chapter).

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## **Report Organization**

Background information related to the history of the state's budgeting process and budgeting roles and authority is provided in the first chapter of the report. Chapter Two presents an overview of state budgeting models and best practices along with program review committee findings about model practices.

The third chapter outline the steps followed in Connecticut to formulate and implement the state's operating budget. Connecticut's major budgeting requirements (e.g., the balanced budget and spending cap laws) and other constraints on the state budgeting process are described in the Chapter Four. A glossary of budgeting terms is included in Appendix A.

Chapter Five contains the program review committee's findings about the state's the budget preparation process along with recommendations intended to improve it. The results of the committee's case study of performance measurement and budgeting for work force development programs are presented in Appendix B.

It is the policy of the Legislative Program Review and Investigations Committee to provide agencies included in the scope of a review with the opportunity to comment on committee findings and recommendations prior to the publication of a final report. A written response to this report was solicited from the Office of Policy and Management (OPM). The response submitted by OPM is contained in Appendix C.

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# I. Background

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## Budget Process History

Until 1969, Connecticut had both biennial legislative sessions and a biennial budget cycle. When the state adopted a constitutional amendment authorizing the legislature to meet in even as well as odd numbered years beginning in 1970, it also went to annual budgeting. Legislative action in the shorter, even-year sessions was intended to be limited to fiscal matters, along with emergencies and any issues of special importance; the budget and all other topics could be taken up during the longer, odd-year sessions.

In 1978 the General Assembly created a “rainy day” fund, formally known as the Budget Reserve Fund, to help the state maintain a balanced budget through economic downturns. The required balance was originally set at 5 percent of annual spending (i.e., net General Fund appropriations), but was increased to 7.5 percent in 2002 and raised to its current 10 percent level during the 2003 regular session.

**Major fiscal reform.** Over the years, biennial budgeting along with formal limits on state spending and bonding have been recommended by various government study groups (e.g., the Thomas and Harper-Hull Commissions) as ways to improve state fiscal management. The General Assembly changed back to a biennial budget cycle beginning with FY 94 as part of a major budgeting and tax reform package enacted in 1991.

The 1991 reform legislation established a state income tax, instituted a spending cap on general budget expenditures, and tightened limits on state bonded indebtedness. A constitutional requirement for a balanced state budget (where the general budget expenditures authorized for a fiscal year cannot exceed the estimated revenues for that year) also went into effect in 1992.

**Performance budgeting.** Legislation enacted in 1981 mandates the governor’s recommended budget be submitted in a program format that includes statements of program objectives and, for the first time, standards for measuring performance. State statute requires the budget document to include “...a statement of performance measures by which accomplishments toward the program objectives can be assessed, which shall include, but not be limited to, an analysis of the workload, quality or level of service and effectiveness of the program...” The program budgeting format was phased in by agency and fully implemented for the FY 86 recommended budget document.

Under a 1992 public act, the Office of Policy and Management (OPM) in consultation with each state agency is required to develop for state budgeting purposes specific biennial goals and objectives and quantifiable outcome measures for each state program and service. OPM is also required to submit an annual report concerning these goals, objectives, and measures to the legislature that includes an evaluation of agency progress in achieving the benchmarks established by the Connecticut Progress Council.<sup>1</sup>

A 1995 public act additionally requires OPM to submit a plan to the legislature for using progress council benchmarks to develop the state budget. It appears OPM instead instructed agencies to incorporate performance measures in their budget requests and pursued some strategic business planning efforts. An October 2002 Office of Legislative Research report notes the progress council benchmarks have played little if any role in the budget process.

In recent years, studies conducted by several groups including the program review committee have found the state budget contains details on program objectives and funding, but does not provide useful performance measures.<sup>2</sup> Program efficiency and effectiveness and progress toward intended missions, therefore, cannot be determined based on the information currently reported. According to the legislature's Office of Fiscal Analysis (OFA), budget decision-making in Connecticut still tends to be incremental and based on adjustments to current service levels, despite statutory requirements about program budgets and performance measurement.

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## **Roles and Authority**

State budgeting responsibilities in Connecticut are carried out primarily by the governor and the legislature with the help of their respective budget staff -- the Office of Policy and Management and the Legislative Office of Fiscal Analysis. As Table 1 shows, all state agencies are involved in developing, executing, and evaluating the state budget. The state comptroller, the state treasurer, and the legislative auditors of public

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<sup>1</sup> The progress council comprises several executive agency heads including the OPM secretary, legislators, and representatives of various private and nonprofit groups. It was created in 1993 to develop a long-range vision for the state and define benchmarks for measuring progress toward that vision. It is also required to submit revised benchmarks to OPM and the General Assembly biennially for use in developing and reviewing the budget. The council issued a report with benchmarks in 1995, but has not met or continued to function since.

<sup>2</sup> See *Performance Measurement*, Legislative Program Review and Investigations Committee, December 1999.



accounts also perform some budget-related functions. The roles of the key players in the process are described briefly below.

<b>Table 1. State Budget Process: Major Roles</b>			
	<i>Main Functions</i>		
	<i>Develop</i>	<i>Execute</i>	<i>Evaluate</i>
<b>General Assembly</b>	✓		✓
• <i>Money Committees (Appropriations and Finance, Revenue &amp; Bonding)</i>	✓		✓
• <i>Substantive Committees</i>			✓
• <i>OFA</i>	✓		✓
<b>Governor</b>	✓	✓	✓
• <i>OPM</i>	✓	✓	✓
• <i>State Agencies</i>	✓	✓	✓
<b>Comptroller</b>			✓
<b>Treasurer</b>			✓
<b>Auditors of Public Accounts</b>			✓

**General Assembly.** Ultimate authority to spend public funds and tax the public is vested in the state legislature. All members of the General Assembly are involved in the adoption of a state budget, although the House and Senate leadership along with the chairpersons and ranking members of the Appropriations and the Finance, Revenue, and Bonding Committees have the most direct roles in the process.

**OFA.** Fiscal analysis is the nonpartisan professional staff office that provides technical financial support to the legislature's Appropriations and Finance Committees as well as to other committees and individual members. OFA staff review budget requests, analyze the fiscal impact of proposed legislation, project cost and revenue trends, and prepare various reports on financial matters related to the appropriations and bonding processes.

**Governor.** The governor's office is directly involved in all phases of the budget process, from instructing agencies about their funding requests, to implementing each fiscal year's appropriations and bonding acts, to monitoring the balance of actual expenditures and revenues throughout the fiscal year. By law, the governor must prepare and present a recommended budget to the General Assembly and execute the final state budget once it is adopted.

The governor is authorized to veto line items within an appropriations act. Under certain circumstances and limitations specified in statute, the

governor can transfer funds among appropriation accounts or reduce individual or total authorized appropriations. In some deficit situations (i.e., if the comptroller reports a General Fund deficit in excess of 1 percent of the fund's appropriations), the governor is required to restrict state spending.

**OPM.** The Office of Policy and Management, the executive branch budget office, is statutorily responsible for preparing the governor's recommended budget and monitoring state budget implementation. The secretary of policy and management, a gubernatorial appointment subject to legislative approval, is the chief state budget officer.

Under the secretary's direction, OPM Budget and Financial Management Division staff review agency funding requests, prepare revenue estimates, and analyze conformity of spending and tax proposals with the governor's policy priorities. OPM is also responsible for allotting (making available for expenditure) the funds authorized in appropriation bills. Through the OPM allotment process, the governor exercises control over agency spending and can, as noted above, modify appropriations during a fiscal year.

**Comptroller.** The state comptroller, a constitutional elected officer, is responsible for keeping, rendering, adjusting, and settling all public accounts. The comptroller must produce monthly statements on the financial status of the state's General Fund as well as publish an annual report available to the public on or before December 31.

**Treasurer.** The state treasurer, also a constitutional elected officer, is the state's chief fiscal officer. The treasurer is responsible for the prudent management and investment of state monies including pension and other trust funds. Under the budget reforms enacted in 1991, the treasurer must certify all bonding bills prior to passage (and before new bond issues are authorized by the state Bond Commission) to ensure their enactment will not cause the state debt ceiling to be exceeded.

**Auditors of Public Accounts.** Two state auditors, one Republican and one Democrat, who are appointed by the General Assembly, head the legislative auditors office. The auditors are responsible for determining whether state agencies are in compliance with state and federal financial requirements.

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## II. Models and Practices

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### Overview of Models

The budgeting models states use at present are the traditional line-item or incremental method and several types of program or performance-based techniques, including some variations of zero-based budgeting. The main approach and focus of each model is summarized in Table 2.

Table 2. State Budget Models		
	<u>Approach</u>	<u>Focus</u>
<b>Line-item</b>	Examines incremental changes to expenditure categories; identifies spending trends but doesn't reflect outputs	Spending control
<b>Zero-based</b>	Examines essential elements of agency or program to determine relative worth and value	Spending priorities
<b>Program</b>	Examines program goals and objectives to determine what is being achieved; may clarify performance levels and needed improvements	Outputs and outcomes
<b>Performance</b>	Examines measurable performance objectives to make budget-related decisions to achieve desired outcomes	Effectiveness

**Line-item budgeting** is easily understood and relatively simple for managers and legislators to implement. It lends itself to incremental decisions to increase or decrease inputs from current levels. While it provides cost accountability, performance is not considered, and management improvement is not encouraged.

**Zero-based budgeting** begins at zero resources and forces the ranking of organizational purposes and programs. The process requires high quality information and accounting systems and considerable time and effort to analyze and prioritize all program functions and alternatives. It can also generate competition and conflict among and within agencies. As a result, pure zero-based budgeting is rarely used, although some states employ variations of the concept (e.g., setting 50 percent of current funding as a base amount or putting 5 to 10 percent of department budgets at risk for reallocation) to help set spending priorities.

**Program and performance budgeting** can clearly define for decision makers and the public what an agency or program does and how it performs. Like zero-based budgeting, these models also need good data systems to be effective, and both additionally involve the difficult task of establishing goals and clear, measurable objectives. Performance

budgeting further requires substantial planning and surveying efforts to determine desired service levels.

In addition, some experts believe that in practice, performance budgeting may have more impact as a management tool than as a budgeting method. While performance information is useful as a guide for resource allocation and often helps set priorities, final funding decisions are often based on other factors including economic conditions, public opinion, and political negotiations.

**Use of models.** Information on state budgeting processes from the National Association of State Budget Officers (NASBO) is summarized in Table 3. As the table shows, most states use a combination of budgeting methods, with incremental and program approaches the most common forms. Connecticut is one of the states that combine incremental and program budgeting methods. Only two states (Alaska and Indiana) just take the incremental approach; all but three states use program and/or performance methods to some extent. One state (Georgia) uses a modification of zero-based budgeting as its sole method, while 11 use a form of zero-based budgeting in combination with performance and/or incremental methods.

**Table 3. Budget Models Used By States, January 2002.**

P	<i>KEY TO MODELS: P = Program; I = Incremental (Line-Item); PF = Performance; Z = Zero-based</i>												
	P I	P PF	P Z	P I PF	P I PF Z	I	I PF	PF	Z	Z P I	Z I PF	Z PF	Z P PF
ID	AL	AR	IA	HI	FL	AK	NH	ME	GA	CA	MO	CO	OR*
IL	AZ	LA	OH*	MN	MT	IN	NM*			DE			VA
MD	CT	TX*		NB*	ND		WA			MI			
MA	KS			NC*									
NV	KY			WV									
NJ*	MS			WI									
PA	NY			WY									
	OK												
	RI												
	SC												
	SD												
	TN												
	UT												
	VT												

\* Nebraska governor's budget is strategic with emphasis on performance measures, but the legislative budget is incremental; New Jersey budget document includes long-range and strategic goals; New Mexico executive budgets are performance based, but judicial and legislative budgets are in transition; North Carolina fully integrated program and performance budgets; Ohio modified zero-based and performance budgets in use; Oregon modified zero-based and program budgeting in place and still incorporating performance; Texas has goals-based budget.

Source of Data: NASBO, *Budget Processes in the States*, January 2002.

**Trends.** Most states have adopted formal requirements for some type of performance-based budgeting in the interest of improving government efficiency, effectiveness, and accountability. Given the challenges to implementation -- developing widely accepted goals, determining true performance measures, establishing comprehensive monitoring and reporting systems, and training and educating users (agency staff, managers, and legislators), few states make full use of either program or performance budgeting methods.

The experiences of four states considered leaders in performance-based budgeting -- Florida, Minnesota, Oregon, and Texas -- were examined in depth to determine what factors contribute to effective implementation. Information about these states compiled by the National Conference of State Legislatures and by program review staff indicated an effective performance budgeting process requires:

- an extended timeframe for implementation,
- adequate staff resources,
- an investment in data management, and,
- most important, the commitment of decision-makers.

Texas and Florida are viewed as having the most successful systems because of strong executive leadership and/or active legislative involvement in developing measures as well as sufficient resources (staff, time, and technology). However, while performance information is considered, it still is not the primary basis for allocation decisions in those states.

***Finding:*** *There is widespread support for budgeting methods that link funding decisions to outcomes. Many states require the use of performance budgeting techniques, but full implementation of the model is challenging. Performance budgeting goals are unlikely to be achieved unless state decision-makers are committed to the process.*

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## **Best Practices**

According to most experts, the primary goals of a state budget process are to ensure expenditures and revenues balance, avoid revenue shortfalls, and reach consensus on policy matters. No single model or set of procedures that ensures achievement of these goals has been identified. One reason is many factors beyond process have an impact on budget outcomes. State budget decisions are influenced by economic conditions, political culture and history, and executive and legislative authority, which can vary greatly over time and from state to state.

There is general agreement about principles that should guide a government budget process and about practices that promote sound fiscal

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management. For example, according to the Government Finance Officers Association (GFOA), good state or local budgeting:

- incorporates a long-term perspective (so a budget is not just an annual balancing of revenues and expenditures but a financial plan for sustaining services and programs over time);
- links the budget to broad organizational goals;
- focuses decisions on results and outcomes;
- involves and promotes effective communication with all stakeholders (i.e., elected officials, administrators, employees and their representatives, citizen groups, and business leaders); and
- provides incentives to managers and employees to improve government efficiency and effectiveness.

Research conducted by the National Conference of State Legislatures (NCSL) concluded the heart of state fiscal management is a balanced budget and identified a number of practices fundamental to sound budgeting. They include:

- established procedures for defining the base budget and forecasting revenue and other statistics, which can foster agreement on basic numbers;
- a formal expenditure reduction mechanism with clearly defined legislative and executive roles;
- flexibility within tax and expenditure limits (e.g., avoid earmarking revenues, consolidate funds to simplify money management, create a stabilization or “rainy day” fund, and maintain a balance in the general fund); and
- avoidance of “quick fixes” (e.g., using one time revenues for ongoing expenses, not calculating annual costs of programs initiated mid year, instituting tax cuts rather than rebates in prosperous years)

**Quality index.** An index created for *State Policy Reports*, a publication of Federal Funds Information for States (FFIS), ranks states on the quality of their budget processes.<sup>3</sup> The State Budget Process Quality Index is based on some widely agreed upon measures of good budget practices as reported by the National Association of State Budget Officers.

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<sup>3</sup> FFIS is a joint subscription information service of the National Governors Association and the National Conference of State Legislatures. The quality index was developed by Hal Hovey, a founding editor of *State Policy Reports* and a national budgeting expert.

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Highest scores on the quality index go to states with:

- strong balanced budget requirements;
- extensive gubernatorial authority to constrain spending;
- large reserves or rainy day funds; and
- understandable budget documents and accounting practices.

The most recent index results, which are based on data collected in 2001, are summarized in Table 4. As the table shows, state scores ranged from a high of 93 (Georgia) to a low of 36 (Vermont) and averaged 70. Connecticut with a score of 76 ranked 18<sup>th</sup> of the 50 states.

<b>Table 4. State Budget Quality Index Results</b>			
<b>Best Practices</b>	<b>CT Score</b>	<b>Perfect Score (Avg. Score)</b>	<b>No. States</b>
<b><i>Balanced Budget Requirements</i></b>	<b>16</b>	<b>20 (14)</b>	
• Legislature enact balanced budget – constitutional	8	8	33
• Governor submit balanced budget – constitutional	0	7	28
• Governor sign balanced budget – constitutional	5	5	34
• Statutes require balanced budget be enacted, submitted, and/or signed	3	9	17
<b><i>Governor's Power to Reduce Spending</i></b>	<b>20</b>	<b>25 (16)</b>	
• Line item veto	10	10	42
• Authority to reduce budget without legislative approval	5	5	36
– Unrestricted authority to reduce	0	10	10
• Quarterly or monthly allotment process	5	5	27
<b><i>Stabilization Funds</i></b>	<b>20</b>	<b>20 (19.7)</b>	
• Rainy day fund	5	5	47
• Amount in reserve (balance as percent of expenditures times 3)	15	15	49
– Actual budget balance (2001) at or above 5%	5%	Range: 5% - 134.6%	37
<b><i>Understandable Budget and Finances</i></b>	<b>20</b>	<b>35 (20)</b>	
• Budget includes information on:			
– Program descriptions	2	2	45
– Caseloads that drive spending	2	2	41
– Number state employees	2	2	48
– Performance indicators/results	2	2	42
– Separate capital outlay presentation	2	2	50
• Use GAAP	0	10	16
• Use multi-year forecasting	5	5	32
• Publish multi-year forecasts	5	5	21
• Appropriate all non-federal funds	0	3	35
• Governor cannot spend unanticipated federal funds without legislative approval	0	2	18
<b><i>TOTAL</i></b>	<b>76</b>	<b>100 (70)</b>	<b>50</b>
Source of data: <i>Index of State Budget Process Quality, State Policy Reports</i> , Vol. 20, Issue 6, March 2002.			

It is important to recognize the index rates a state's formal process only and not its actual budgeting practices or outcomes. Thus, a state with a high quality index score could be in poor financial condition while a low scoring state might be in better than average fiscal shape. California is an example of the first case. Vermont, which informally carries out many of the index's recommended procedures, is an example of the latter.

Connecticut's formal budget process incorporates most of best practices measured by the quality index. The five practices Connecticut has not adopted are: a constitutional requirement that the governor submit a balanced budget; legislative approval of unanticipated federal funds; appropriation of all nonfederal funds; unrestricted gubernatorial authority to reduce spending; and use of Generally Accepted Accounting Principles (GAAP).

**Performance grade.** State financial management systems, which include budgeting practices, are one of five key systems evaluated through the multi-year Government Performance Project carried out by Syracuse University (Campbell Public Affairs Institute of the Maxwell School) and *Governing* magazine. To date, the project has conducted criteria-based assessments and ranked the financial and other management activities in all 50 states in 1998 and again in 2000.

Grades given to the states by the project are a summary measure of the potential for performance and reflect how well available resources have been used to create sound systems to support good decision making and service delivery. The project's financial management assessment focuses on budget allocation, forecasting, budget execution, accounting, financial reporting, debt management, and investment. Over 70 descriptive statistics related to the following criteria were measured to grade each state's financial management system:

- the government has a multi-year perspective on budgeting;
- the government has mechanisms that preserve stability and fiscal health;
- sufficient financial information is available to policymakers, managers, and citizens; and
- the government has appropriate control over financial operations.

The 50-state average grade for financial management in the 1999-2000 fiscal year was a B. Ten states received grades of A or A-, the highest marks given, and six states including Connecticut received grades of C, the lowest mark. All states with the highest and lowest grades for financial management are listed in Table 5.



Connecticut's most recent assessment noted some improvements since its 1998 evaluation. These included a healthier rainy day fund, closer attention to the fiscal impact of legislation, and use of year-end surplus money for one-time rather than recurring expenditures. The decline in the state's accumulated deficit was also viewed as a positive practice.

Negative practices cited by the project were the state's accounting method, which records revenues at a faster rate than expenditures and does not comply with GAAP principles, unfunded pensions liabilities, and repeated emergency declarations to permit expenditures above the state spending cap.

**Table 5. Financial Management Grades for Selected States**

<i>STATE</i>	<i>GOVT. PERF. FIN. MGT. GRADE FY 00</i>	<i>BUDGET PROCESS QUALITY INDEX SCORE</i>	<i>FY 02 BUDGET BALANCE*</i>
<b><u>Highest Grades</u></b>			
<b>Utah</b>	A	82	0.6%
<b>Delaware</b>	A-	67	19.6%
<b>Iowa</b>	A-	83	5.5%
<b>Kentucky</b>	A-	68	0.3%
<b>Maryland</b>	A-	63	7.8%
<b>Michigan</b>	A-	88	2.8%
<b>Minnesota</b>	A-	85	8.9%
<b>Nebraska</b>	A-	64	6.4%
<b>Pennsylvania</b>	A-	72	0.7%
<b>South Carolina</b>	A-	53	1.0%
<b><u>Lowest Grades</u></b>			
<b>Alaska</b>	C	64	88.4%
<b>Arizona</b>	C	63	1.0%
<b>Connecticut</b>	C	76	0.0%
<b>Hawaii</b>	C	77	5.0%
<b>Louisiana</b>	C	77	4.4%
<b>Tennessee</b>	C	56	2.5%

\* NOTE: Total state budget balance (ending balance plus any budget stabilization funds) as percentage of appropriated expenditures for FY 02

Sources of data: The Government Performance Project, <http://www.maxwell.syr.edu/gpp/> and NASBO, The Fiscal Survey of the States, June 2003.

In addition to each state's financial management grade, Table 5 shows its quality index score and most recent available (FY 02) budget balance data. In comparing these measures, it is interesting to note the 10 states with the highest marks for financial management did not always have the best quality index ratings. Five, in fact, had index scores below average (under 70). In contrast, all six states that received Cs for financial management also had about average or below average quality index scores.

Budget balances also seem unrelated to financial management or quality process rankings. Alaska, which consistently has the highest balances in the country and was at almost 90 percent of its authorized expenditure level for FY 02, has only average process and management ratings. Delaware had the second-highest FY 02 budget balance as well as very high process and management marks, but Utah, which ranked highest on financial management, had a fund balance below 1 percent.

Table 5 demonstrates the relationship between budgeting practices and financial condition is not simple. As noted earlier, a state may have a high quality process in statute but never implement components critical for a balanced budget. Furthermore, it is not clear how much good budgeting policies and procedures can mitigate the effects of economic conditions, particularly extreme downturns.

***Finding:*** *While it appears having recommended budget practices in place does not guarantee a sound financial condition, their application may increase the potential for good fiscal performance. Experts agree more research is needed to understand the link between specific budgeting practices and fiscal outcomes.*

The following sections discuss in more detail budgeting practices experts consider to be among the most important to good outcomes. These include: accurate forecasting, stabilization (rainy day) funds, formal spending controls, and understandable information. The impact of the budget cycle (annual vs. biennial budgeting) is also discussed below.

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## Forecasting

Accurate expenditure and revenue projections can contribute significantly to the development of a balanced budget. Good forecasting, based on objective, complete data and generally accepted methodologies, also can reduce conflict, at least over the basic numbers, during the budgeting process and increase public confidence in the decisions made.

Estimates of future spending needs generally are prepared by state budget offices based on current and anticipated cost information supplied by agencies. Adjustments are made for inflation and other variables that impact spending (e.g., caseload trends, program policy changes, and facility modifications). Most states (32) including Connecticut prepare multi-year forecasts of operating expenditures, for at least one and up to 10 years beyond the current budget cycle. More than half of the states also publish projected expenditures, either within the budget document (22) or in a separate publication (7).

A variety of entities carry out state revenue forecasting functions. As Table 6 shows, revenue estimates contained in a governor's budget may be

prepared by budget offices, revenue offices, separate forecasting boards, or through a combination of these and other parties including the legislature. The majority of states (31) rely on just their budget office, revenue office or a separate board for revenue forecasts. Revenue projections are prepared by a combination of entities in the remaining (19) states.

**Table 6. Responsibility for State Revenue Forecasting**

<i><b>Budget Office (14)</b></i>	<i><b>Revenue Office (3)</b></i>	<i><b>Separate Board or Commission (14)</b></i>	<i><b>Budget &amp; Revenue Offices (8)</b></i>	<i><b>Other Combination (11, see KEY below)</b></i>
Alabama	Alaska	Delaware	Arizona	Arkansas (B,C)
California	Texas	Florida	Massachusetts	Indiana (B,C)
Colorado	Wisconsin	Hawaii	Montana	Michigan (B,R,L*)
Connecticut		Iowa	New Jersey	Mississippi (G,L)
Georgia		Kansas	North Dakota	New Hampshire
Idaho		Kentucky	Pennsylvania	(B,G)
Illinois		Louisiana	Utah	New Mexico (B,R,L)
Minnesota		Maine	West Virginia	North Carolina
Missouri		Maryland		(B,G,L)
New York		Nebraska		Oklahoma (B,R,C)
Ohio		Nevada		Vermont (B*,L)
Oregon*		Rhode Island		Virginia (B,R,C)
South		South Carolina		Washington (B,C)
Dakota		Wyoming		
Tennessee				

**KEY to Combinations:** *B= Budget Office, C= Separate Board/Commission, G= Governor, L= Legislature, R= Revenue Office*

\* In Oregon, the Department of Administrative Services, Office of Economic Analysis prepares the forecast; in Michigan, it is a consensus procedure involving the budget and revenue agencies and the legislature; in Vermont, the Emergency Board comprised of four legislators chaired by the governor determines the forecast based on executive and legislative branch estimates.

Source of data: NASBO, Budget Processes in the States, January 2002.

The final official revenue estimate is binding in 26 states including Connecticut. In these states, total appropriations are restricted to the official estimate amount or, in some cases, a percentage of that figure. All states monitor and revise their estimates throughout the fiscal year to ensure expenditures track actual revenues.

Recent research indicates states can improve their forecasting processes by seeking consensus in developing estimates, employing the best available economic data, and using the expertise of academic and business economists. Timing issues and economic conditions, however, appear to have the most influence on the quality of forecasts. One study concluded "...a stable economy probably does more to ensure an accurate estimate than any process improvements."<sup>4</sup>

<sup>4</sup> *State Policy Reports*, Vol. 20, Issue 13 (July 2002), p. 7.

***Finding:*** *Accurate multi-year projections of expenditures and revenues are essential to effective budget decision making. Good forecasting practices can improve the quality of estimates. However, accuracy will always be difficult to attain when economic conditions are volatile.*

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## **Stabilization Funds**

Many states have developed the practice of building up surpluses in good economic times to help mitigate budget shortfalls during recessions. As of 2002, all but four states had created formal budget stabilization funds, also known as budget reserve or rainy day funds, as a tool for dealing with unanticipated deficits.<sup>5</sup> Ideally, stabilization funds allow states to maintain spending during a recession without having to raise taxes. Such funds act as a savings account and, depending on individual state requirements, can serve as:

- a cushion for forecasting errors;
- a reserve to pay one-time expenses (e.g., related to a court settlement or natural disaster); or
- working funds to meet cash flow requirements during tight budget times.

While the State Budget Process Quality Index gives high marks to healthy state rainy day funds, there is not total agreement among experts about their impact on state financial management systems. Some of the positive and negative aspects attributed to budget stabilization funds are:

<u>Positive</u>	<u>Negative</u>
<ul style="list-style-type: none"><li>• Promotes stability because avoids, at least temporarily, ad hoc cuts or tax increases</li><li>• Permits time for informed decision making (avoids budgeting during a crisis atmosphere)</li><li>• Reduces the amount of one-time revenues used to fund expenditures</li><li>• Bond-rating agencies view favorably</li></ul>	<ul style="list-style-type: none"><li>• Holds excess revenues that could be returned to taxpayers</li><li>• Delays permanent solutions to budget problems (e.g., budget cuts, tax increases)</li><li>• Tempting revenue source for programs when times are good</li><li>• May not be accessible if use will result in lower bond rating</li></ul>

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<sup>5</sup> According to NASBO, Arkansas, Montana, Oregon, and Kansas do not have stabilization funds although Kansas is required by law to maintain an ending year balance at 7.5 percent of upcoming fiscal year total expenditures.

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**Fund size.** Deposits to stabilization funds are automatic in some states (e.g., surpluses are transferred to the fund up to a cap amount at the end of the fiscal year) while in other states monies are appropriated by the legislature. The majority of states (36) cap the size of their funds. Most set the cap as a percentage of revenues, expenditures, or appropriations but some set a specific dollar amount. Overall, limits on fund size range from 3 to 10 percent of either revenues or appropriations.

At one time, 5 percent of expenditures was considered the ideal amount for a rainy day fund. Recent studies have challenged this standard, pointing out that states with greater budgetary volatility are likely to need larger reserve amounts while smaller funds might be sufficient for more stable states.

Experts further note more research is needed to understand the factors that contribute to an unstable budget environment as well as how to determine the appropriate size of a rainy day fund. Among the factors states need to consider are demographics (e.g., rapid growth in the school age or elderly populations), tax structure (e.g., heavy reliance on a sales tax or lack of an income tax), and economic environment (e.g., industry mix).

**Fund use.** Typically, expenditures from a rainy day fund require authorization by the legislature. Some states also have supermajority requirements for stabilization fund withdrawals (e.g., approval by a two-thirds or three-quarters legislative vote). Most states place restrictions on the use of rainy day funds.

***Finding:*** *Stabilization funds can be effective counter-cyclical fiscal mechanisms if properly funded and used. The balance a state needs to maintain in a rainy day fund should be related to the risks of its budgetary environment.*

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## Spending Controls

Appropriate control over spending is another aspect of state budgeting and financial management evaluated by the quality index and the Government Performance Project. The primary ways states restrict expenditures are described below.

**Balanced budget requirements.** One of the most effective fiscal controls over state budget deficits is a strong balanced budget requirement. Most states have some type of requirement, either constitutional or statutory, for balancing their budgets. Governors are required to present balanced budgets in 44 states, the legislature is required to pass a balanced budget in 40 states, and governors must sign a balanced budget in 34 states. Twenty

states have constitutional balanced budget mandates for all three components of the process.

**Spending caps.** Statutory and constitutional tax and expenditure limits are another mechanism states use to control spending growth and keep budgets balanced. Thirty states have established limitations on revenue and spending increases. In 21 of these states, growth in appropriations is limited to an inflation index. Revenue increases require a supermajority vote in 12 states and voter approval in another three.

A survey of all 50 states conducted by OFA in 2001 found 23 states including Connecticut had adopted spending caps. All but eight of these states exempted certain funds from the expenditure limit, with the most common exemptions being debt service, federal mandates, court orders, grants to towns, Medicaid, capital outlays, and federal funds.

Recent studies indicate tax and expenditure limits have had mixed results. For example, there is evidence caps on revenue increases do little to contain the rate of tax increases. Spending caps, in some instances appear to have caused states to borrow funds to cover operating costs. Experts also point out overly restrictive limits on the ability to raise taxes and increase expenditures can actually be harmful to a state's financial condition.

**Governor's authority to cut budgets.** Most states give their governors the power to reduce state operating budgets during a fiscal year. Some require the governor to make spending cuts if expenditure exceeds revenues by a certain amount.

In 12 states, governors have explicit authority to restrict spending selectively or across-the-board without legislative approval. Governors can make unlimited across-the-board cuts in 10 state and in another seven are permitted to reduce spending up to a specified percentage without legislative approval. In 12 other states governors must consult with the legislature on cuts to enacted budgets.

The quality index gives states with unrestricted gubernatorial authority to reduce budgets the highest ratings. The idea is to allow the governor to respond as quickly as possible to balance the budget. However, some experts point out the most efficient measures for the short term, such as across-the-board cuts, may not be the best long-term solution to a fiscal crisis. Allowing legislative input and debate could promote better policy decisions. Another concern is allowing the governor too much authority to set priorities for limited resources.

***Finding:*** *Formal controls on spending can be an effective means of achieving a balanced budget. Overly restrictive tax and spending limits,*

*or weak balanced budget requirements, however, can have unintended negative consequences for a state's financial management practices.*

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## **Understandable Information**

According to experts, the way budget information is communicated and presented has an impact on how well a budget is received and understood by decision makers and the public. One of the main financial management criteria evaluated by the Government Performance Project is sufficient budgetary information available for policymakers, managers, and citizens. State grades are based on the following best practices for budgetary information:

- accurate, reliable, and thorough financial reports;
- useful financial information available to managers;
- budgetary and financial data communicated to citizens;
- timely financial reports; and
- ability to gauge the cost of delivering goods and services.

The State Budget Process Quality Index assesses the comprehensiveness of state budget documents based on the types of information they provide. Good documents address all of the following five subjects: program descriptions; caseloads that drive spending; number of employees; performance indicators or results expected from expenditures; and a separate presentation of capital outlays. Highest scores go to states with budgets that reveal the impact of current decisions on future budgets, use accepted accounting principles, cover all state money, and disclose spending purposes.

Rhode Island received a perfect quality index score in the understandable finances category and Georgia, Iowa, Michigan, and New York also ranked in the top five. Connecticut received an average score and ranked in the middle (28) of the 50 states.

**GAAP.** Both the quality index and the government performance project give favorable ratings to states that use Generally Accepted Accounting Principles for budgeting. GAAP, which has more rigid standards than other accounting systems, is the basis for corporate financial statements. Investors in state bonds and notes generally review financial information prepared on a GAAP basis.

Reporting financial information on a GAAP basis makes state data comparable and also limits artificially positive outlooks. At present, only 16 states use GAAP for their budgets (Alaska, Arkansas, California,

Georgia, Illinois, Iowa, Michigan, Mississippi, Montana, New Jersey, New Mexico, New York, Rhode Island, Utah, Washington, and Wyoming).

The Connecticut legislature enacted a statutory requirement (C.G.S. Section 3-115b) to use GAAP for budgeting and financial reporting in 1993 but has postponed the implementation date in subsequent sessions. Currently, GAAP accounting is scheduled to go into effect beginning for the fiscal year beginning July 1, 2005 (P.A. 03-1, June 30 SS).

Although Connecticut has not adopted GAAP for budgeting or financial control purposes, the state comptroller uses the system for several of its reports, including the state Comprehensive Annual Financial Report (CARF). At present, a modified cash accounting system, also called the budgetary basis, is used to prepare the state's budgets and reports on spending and receipts.

The differences between figures reported according to GAAP standards and other accounting methods can be substantial as Table 7 indicates. The table compares Connecticut's General Fund budget balance each year based on GAAP and on the state's modified cash accounting system over the past 10 fiscal years.

In some cases, the variation in amounts is relatively minor. However, for three fiscal years the difference is more than \$100 million and for FY 02, the difference in the reported deficit is more than \$1 billion. For two fiscal years, the ending balance appears as a deficit on a GAAP basis but as a surplus on the state budgetary basis, which is the result of differences in accounting practices between the two systems.

**Table 7. Connecticut General Fund Budget Balance:  
FY 93 – FY 02 (dollars in millions)**

	<i>FY93</i>	<i>FY94</i>	<i>FY95</i>	<i>FY96</i>	<i>FY97</i>	<i>FY98</i>	<i>FY99</i>	<i>FY00</i>	<i>FY01</i>	<i>FY02</i>
<b>State Bud. Basis</b>	\$113.4	\$19.6	\$80.5	\$249.9	\$262.6	\$312.9	\$71.7	\$300.4	\$30.6	(\$222.3)
<b>GAAP Basis</b>	\$99.2	\$53.8	(\$231.1)	\$202.3	\$252.8	\$390.7	\$174.9	(\$72.8)	\$33.2	(\$1,261.0)
<b>Diff. (State - GAAP)</b>	\$14.2	(\$34.1)	\$311.6	\$47.5	\$9.7	(\$77.8)	(\$103.1)	\$373.5	(\$2.5)	\$1,038.7

Source of Data: Office of the State Comptroller.

According to the Connecticut comptroller's June 2, 2003, monthly financial report: "The difference between budgetary [state modified cash accounting system] and GAAP basis projections is primarily due to the recognition under GAAP of the projected liabilities, revenues, and other



items which will be outstanding at year end and which are not reflected in the modified cash basis currently used for budgetary reporting.”

*Finding: Accurate, reliable, and consistently reported data combined with a transparent budget preparation process contribute to public confidence in fiscal decision making. Understandable documents and procedures can also reduce conflict throughout a budgeting process.*

## Budget Cycle

All states use either a one-year or two-year budget cycle. As Table 8 shows, the majority of states (27) have an annual budget cycle, while two use a combination of annual and biennial budgeting. The remaining states (21) have biennial budgets. However, only three (Oregon, North Dakota, and Wyoming) actually enact consolidated two-year budgets. More commonly, the states with biennial budgeting, including Connecticut, enact separate budgets for two fiscal years at the same time.

**Table 8. State Budget Cycles**

Annual (27)	Biennial (21)*	Combination (2)
Alabama, Alaska, California, Colorado, Delaware, Florida, Georgia, Indiana, Illinois, Iowa, Louisiana, Maryland, Massachusetts, Michigan, Mississippi, New Jersey, New Mexico, New York, Oklahoma, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Vermont, West Virginia	<i>Arizona, Arkansas, Connecticut, Hawaii, * Indiana, Kentucky, Maine, Minnesota, Montana, Nebraska, Nevada, New Hampshire, North Carolina, North Dakota, Ohio, Oregon, Texas, Virginia, Washington, Wisconsin, Wyoming</i>	Kansas Missouri

\* Biennial budget states shown in italics have annual legislative sessions; Hawaii by constitution has biennial budgeting but in practice budgets annually.

Source of Data: NASBO, January 2002.

States with biennial budgeting and annual legislative sessions can and do revisit their second-year budgets. Legislatures in 12 of the states with biennial budgeting, including Connecticut, meet annually.

The trend in recent years is toward annual budgeting, which experts attribute in part to more complicated state budgets, larger and more federal grants, and less stable state revenue streams. However, there is no empirical evidence indicating one cycle is superior over the other. The advantages generally attributed to each are:

Annual Budgeting

- More time devoted to budget analysis
- Enhances budget oversight by more frequent legislative review
- Increases accuracy of estimates
- Greater opportunity for legislative control over federal funds
- Reduced need for supplemental appropriations and special sessions

Biennial Budgeting

- More conducive to long-term planning
- Allows legislators to concentrate on major policy issues
- More time for debate on non budget issues
- Provides greater opportunity for program review and evaluation
- Less expensive and time-consuming to prepare and adopt

Overall, state experience has shown economic conditions largely determine how efficiently a budget is enacted and the extent of revisions. There is some evidence biennial sessions promote performance review and evaluation, but long-term planning appears unrelated to the budget cycle. Forecasting is more accurate for annual budgets, while it appears biennial budgeting may somewhat reduce budgeting costs for executive agencies.

***Finding:*** *Good fiscal controls and planning are possible under either annual or biennial budgeting. Budgeting success seems more dependent on economic conditions and the commitment of decision makers than the length of the budget cycle.*

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### III. Connecticut Process

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In Connecticut, the procedures to develop and implement the state budget are primarily defined by state law (C.G.S. §4-69 *et seq.*). State constitutional provisions also mandate certain budget practices and the rules of the Connecticut General Assembly (House, Senate, and joint) provide guidance for legislative consideration of state budget matters.

Figure 1 outlines the basic steps in Connecticut's General Fund budget process. The major steps in formulating the state's operating budget are described first and followed by an overview of the implementation phase of the budget process.

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#### Timeline

Connecticut operates on a two-year or biennial budget cycle. In odd-numbered years, a state budget is developed for the upcoming two fiscal years. The state's fiscal year runs from July 1 through June 30. The budget adopted in odd-numbered years is revised as needed in even-numbered years. However, the process is essentially the same for the first and second years of the biennium.

As Figure 1 indicates, the state budget process occurs year round. It begins approximately 11 months prior to the effective date of the upcoming biennial budget cycle. State agencies begin to prepare their biennial budget requests between May and August of the preceding year. Budget guidelines and instructions developed by the Office of Policy and Management are provided to agencies by August 1<sup>st</sup>.

Biennial budget requests must be submitted to OPM on or before September 1<sup>st</sup> of each even-numbered year, and program options are due October 1<sup>st</sup>. Necessary adjustments and revisions to second year budget requests are submitted in each odd-numbered year. (C.G.S. § 4-77)

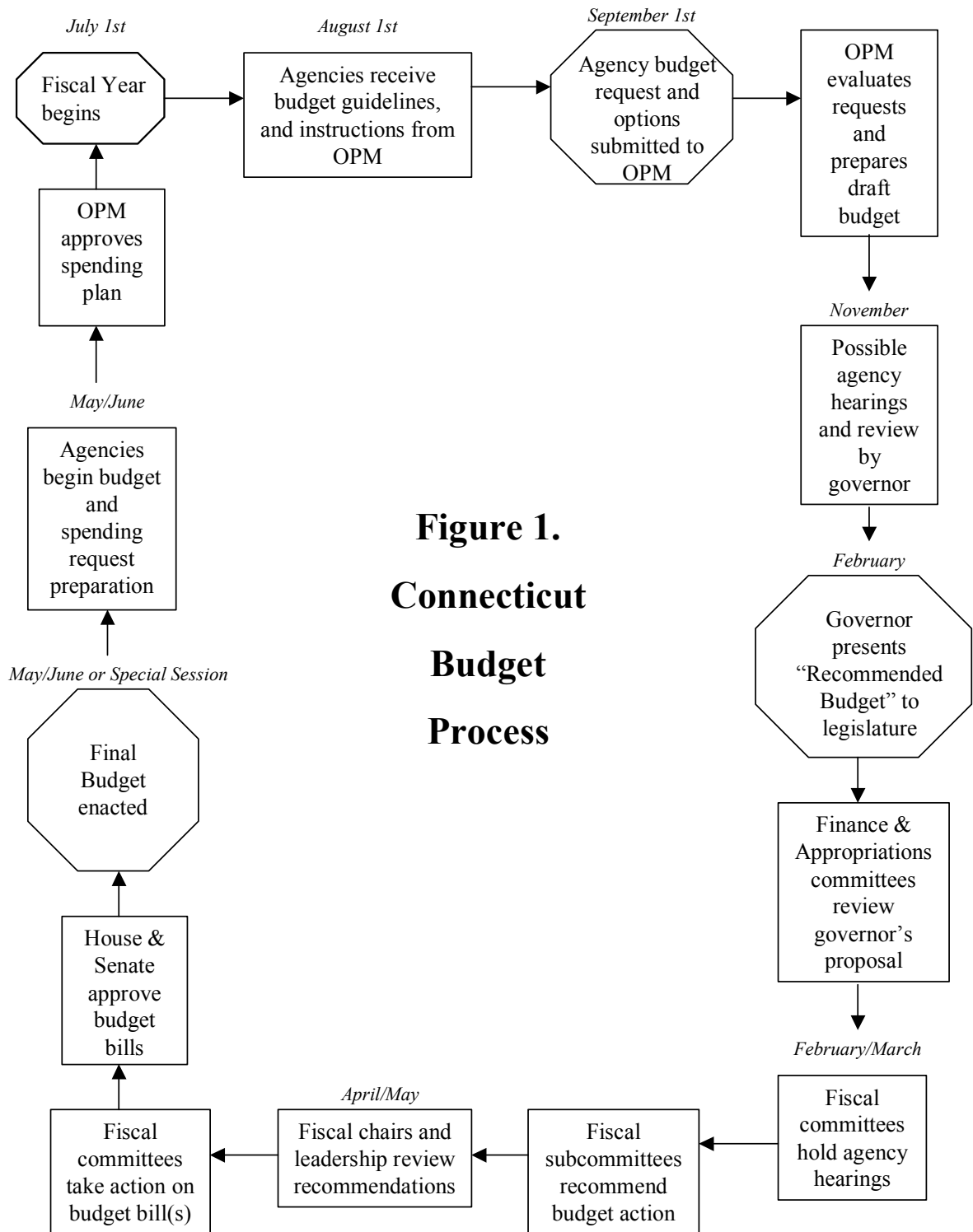
After review and analysis of the agencies' budget requests, OPM staff prepare recommendations for the OPM secretary on the overall budget proposal. The recommendations are then transmitted to the governor for review.<sup>6</sup>

State law permits the governor to hold agency budget hearings. During the governor's review, usually in December and January, final executive

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<sup>6</sup> In years when there is a newly elected governor, the OPM secretary must prepare and submit recommendations to the governor by November 15<sup>th</sup> for review. (C.G.S. §4-79).

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**Figure 1.**  
**Connecticut**  
**Budget**  
**Process**

policy decisions are made and incorporated in the final recommended budget.

The governor presents the budget to the legislature during a “state of the state” message that stresses the administration’s particular priorities. The governor is statutorily required to submit a budget recommendation to the General Assembly on the first day of a session following February 3 in odd-numbered years or on the Wednesday after the first Monday in February (the day the General Assembly convenes) in sessions falling in even-numbered years.<sup>7</sup>

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## **Governor’s Budget**

Connecticut General Statutes § 4-72 through 4-74a set out specific content requirements for the governor’s budget document. By law, the recommended budget must contain four parts with the following information:

- Part I**
  - Governor’s budget message
  - Budget-in-Brief (summaries of recommendations, appropriations, revenue bonds, positions, and capital program)
  - Financial statements detailing the condition of the state debt and the financial position of all major state operating funds
  - Recommended appropriations and state revenues on an actual basis for the last completed year and on an estimated basis for the current fiscal year and the upcoming fiscal year
  - Recommendations for the manner in which a projected deficit will be met or a projected surplus be used
  
- Part II**
  - Budget-in-Detail (agency operating budgets in 11 functional areas and the state’s capital budget for each fiscal year of the biennium)
  - Appropriations needed to meet the cost of each major function and program
  - Detailed narrative of work to be accomplished through the appropriation
  - Cost of each agency and program function detailed under standard classifications of expenses (i.e., debt service, personal services, contractual services, equipment, and state aid grants)
  - Accounting of federal funds
  - Recommendations for the capital program

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<sup>7</sup> In a year where the governor has been elected or succeeded as governor since the submission of the last budget document, the governor must present the biennial budget recommendations and reports to the legislature by the first session day following February 14<sup>th</sup>.

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- Part III**
  - Drafts of appropriations, bonding, and revenue bills to carry out the recommendations
  - Proposed bills must indicate the funds from which appropriation will be paid and the appropriations for each agency and major subdivision
- Part IV**
  - Governor's report on the state's economy including:
    - an analysis of the impact of proposed spending and revenue programs on the economy; and
    - assumptions on which the estimated revenues and expenditures are based

In even-numbered years, the governor prepares a status report on the adopted budget, along with any recommended revisions and adjustments, including estimated revenues and expenditures for the next three years. The purpose of the out-year projection is to illustrate the impact of the proposed budget on future state revenues and expenditures.

**Operating budget.** The state's operating budget contained in the governor's Budget-in-Detail is broken into several categories or functions of government. The government functions are: Legislative; General Government; Regulation and Protection; Conservation and Development; Health and Hospitals; Transportation; Human Services; Education; Corrections; Judicial; and Non-functional. (Non-functional refers to accounts that do not automatically fit into one of the other categories of government and includes items such as debt service and a number of miscellaneous appropriations administered by the comptroller.)

Each agency's budget begins with a description of its mission and statutory responsibilities. This is followed by a summary of recommended significant changes. This may include reductions in current services, reallocation or transfers of funds, revenues, or new and expanded services.

An agency-wide summary of personnel and funding is also provided. This is further outlined and detailed in the subsequent description of each major program and function within the department.

Each major program description contains a statutory reference, a statement of need, program objective, and a general program description. In addition, each agency reports on program measures.

Next, a "personnel summary" and a "financial summary" are provided for each major agency program. The personnel summary gives the filled and vacant permanent, full-time positions from the General Fund and federal contribution positions. These positions are reported for the upcoming two fiscal years as well as the current fiscal year. Actual funded positions for the current fiscal year are presented first (filled, vacant, change, and total). The agency's requested positions for the upcoming fiscal years are then reported along with the governor's recommended numbers.

Each agency's financial summary contains the following:

- General Fund personal services and other current expenses;
- payments to local governments and payments to other than local governments;
- equipment;
- additional funds available including special funds, federal and private contributions; and
- agency totals.

This fiscal information is presented by actual expenditures for the past fiscal year, estimated for the current fiscal year, requested and recommended for the next two fiscal years.

**Prevention budget.** In 2001, the legislature mandated the governor include a prevention report in the budget document beginning with the FY 2003-05 biennial budget. The report must detail the governor's recommendation for prevention services appropriations. The governor's budget must also include a summary of prevention services by agency, identifying the total expenditure for prevention services in the budget.

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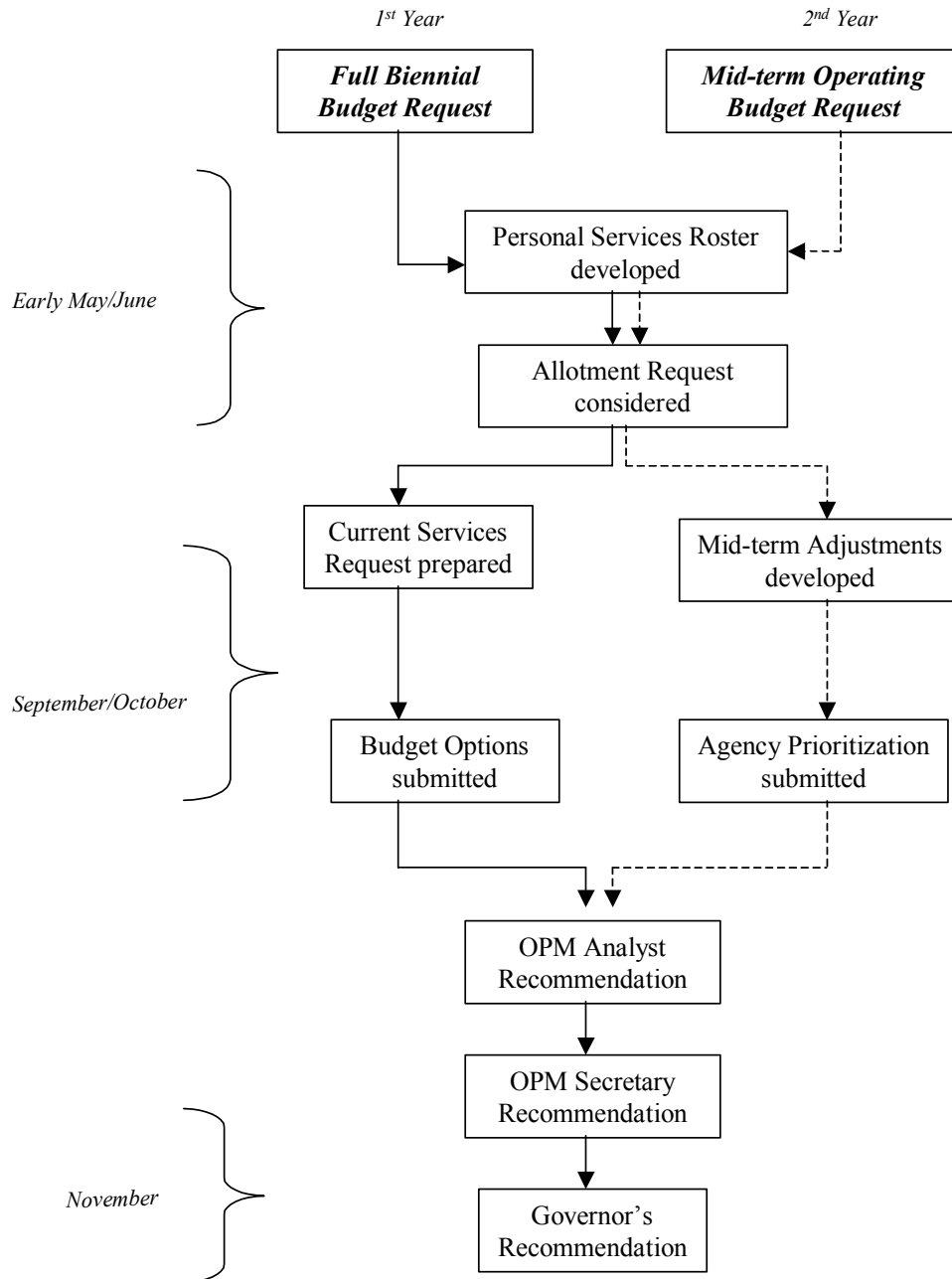
## **Budget Preparation**

The process followed by state agencies and OPM to prepare the governor's recommended biennial budget and second-year revisions (midterm operating budget) is shown in Figure 2. State agencies are required to produce and submit a variety of detailed reports and information through OPM's automated budget system. These reports are prepared using software and an instruction manual provided by OPM.

In addition to the instruction manual, policy guidelines may be issued separately and take precedence over any general instructions. Agencies may not deviate from the instructions without prior approval from OPM. The agency must discuss its plans with its OPM budget analyst prior to taking such action to ensure that information is provided in a form acceptable to OPM.

**Biennial request.** The biennial budget request process begins in early May. OPM provides automated personnel information to state agencies along with software tools to develop a personal services roster and assist with the budget preparation. The agencies use the software applications

**Figure 2. OPM Budget Preparation Process**





for various purposes including to scan for incorrect or missing data, and to update the roster for filled/vacant positions, promotions and upgrades.

The roster assists the agencies in its development of quarterly appropriation allotment requests in early June. This forms the basis for the agencies' Current Services Request required by September 1<sup>st</sup>. The roster feeds continuing fulltime position calculations for both budget years. The costs of settled collective bargaining agreements are automatically built into the automated budget system.

In addition, actual expenditure information from the comptroller's accounting system is used to formulate recommended expenditures. The administrative head of each budgeted agency uses this information to prepare estimates of expenditure requirements for the next biennium.

For the first budget year, OPM will instruct agencies to provide current level funding estimates with necessary adjustments for inflation, annualization of partial year costs, projected caseload increases or declines, the completion of projects, and other known factors with an impact on the budget. State agencies must explain requests that exceed inflationary guidelines. Agencies must also provide additional information for major expenditure items that have an impact on out-year projections.

Agencies also are required to present a separate list of options for program changes or expansions. Depending on OPM's instructions, the options may include proposals to cut programs or services or reallocate funding among agency accounts. Options are based on gubernatorial policy and begin with prioritization of agency activities.

Each agency is asked to review every activity it performs and determine whether these activities are appropriate and necessary core functions or if better ways exist to accomplish the goal. Options may include potential mergers and program consolidations. Options are to provide alternatives that reflect the administration's priorities and remain within available revenues. Agencies must also examine options to secure additional revenue. Options are typically due in October. Agencies also must supply OFA with hard copies of their budget requests and options.

**Midterm request.** The process for preparing the midterm operating budget request is similar to the full biennial request process. As in the process for the full biennium budget, agencies must submit their personal services roster and allotment request. Midterm adjustments may be necessary for newly enacted legislation or revised estimates for mandated or formula driven expenditures. In addition, each agency is asked to prioritize its activities as it would for options.

According to OPM instructions, agency prioritization requires agencies to consider the following questions:

- *Are the activity's benefits consistent with the agency's mission?*
- *What benefits do the agency's clients derive from this activity?*
- *Does this activity increase the agency's success in meeting the needs of its clients?*
- *Do other agencies participate in this activity (or should they)? Does activity fit agency core functions or should it be transferred elsewhere or not done at all?*
- *What activities are outdated or continuing only due to outside influences like a vocal special interest group?*
- *Have any activities been reduced to a level of mediocrity that should cause redirection of resources?*

Similar to the full biennium process, the steps for the midterm process begin in early May and are completed in September/October.

**OPM review of budget requests.** OPM is responsible for analysis of agency submissions by reviewing and compiling the requests into a statewide budget proposal for the governor's approval. Staff analysts within OPM's Budget and Financial Management Division review requests and prepare recommendations for the agencies within their jurisdiction. Throughout the process budget office staff will work with agency staff to clarify agency requests. Communications between OPM and the state agencies may be conducted through agency budget meetings or less formal means.

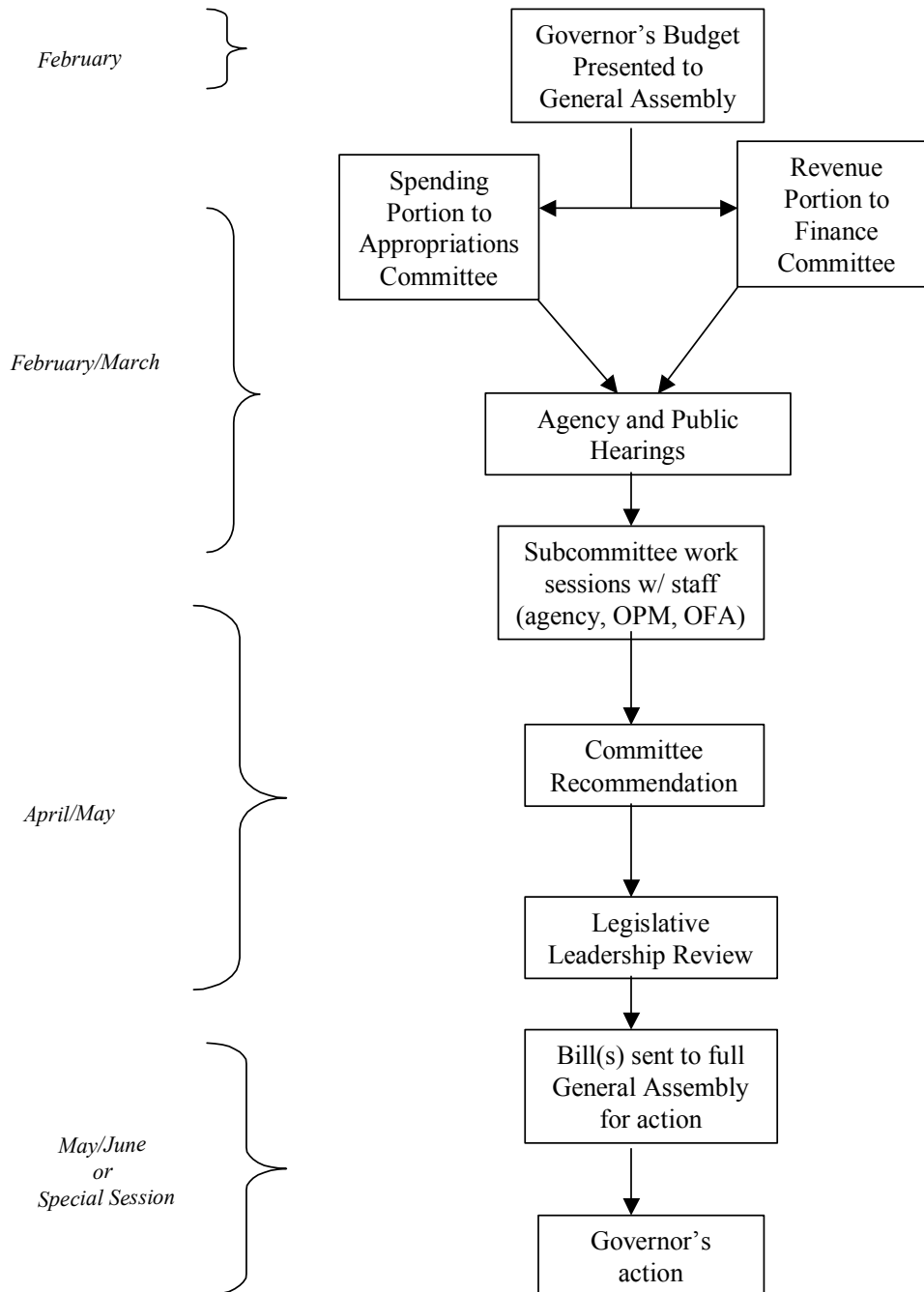
Budget analysts examine the efficiency and effectiveness of existing programs as well as the need for new and expanded programs. OPM will also estimate what state revenues will be for the year. After review and analysis on the agencies' budget requests, OPM staff prepare recommendations for the OPM secretary on the overall budget proposal. The secretary of OPM reviews these recommendations making adjustments based on revenue estimates and the administration's determination of which needs have highest priority. The recommendations are then transmitted to the governor for review.

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## Legislative Consideration

After the governor's presentation to the General Assembly, the proposed budget is considered by the legislature. Steps in the legislature's process are shown in Figure 3.

**Figure 3. Legislative Consideration**



As the figure indicates, the proposed budget submitted by the governor is parceled out for subject matter review. The Appropriations Committee reviews the spending side of the budget, while the Finance, Revenue and Bonding Committee receives the revenue portion of the budget. Both of these committees have members from the House and Senate and are co-chaired by a senator and a representative.

**Appropriations committee.** The 54-member Appropriations Committee reviews all bills with any impact on expenditures and holds public hearings on each agency's requested budget. The budget is then divided again by content area and each area is sent to one of 12 appropriation subcommittees.

The appropriation subcommittees review each agency's operating budgets in work sessions with agency heads, OPM and OFA staff. Each subcommittee has two chairs, a senator and a representative from the majority party of each house. The subcommittees are: Legislative; General Government A; General Government B; Regulation and Protection; Conservation and Development; Health and Hospitals; Human Services; Transportation; Elementary and Secondary Education; Higher Education; Judicial and Corrections; and Collective Bargaining.

**Finance committee.** Simultaneously, the 46-member Finance, Revenue and Bonding committee and its subcommittees review the revenue and capital projects portions of the budget. Each fiscal subcommittee may hold public hearings on the various parts of the budget in February and March. The various subcommittees work with OFA staff to develop and present recommendations to the full committee through its chairpersons.

**Action by full legislature.** Leadership may review and refine both committees' recommendations. The spending recommendations are put into the committee's appropriations bill. The full committee votes on a final bill in April or May. The final committee bills are then submitted for floor action. The title of the biennial budget bill must be "An Act Concerning the State Budget for the Biennium Ending June Thirtieth (calendar year) and Making Appropriations Therefor." OFA staff prepares an Appropriations Committee budget report containing legislative intent for all changes to agency budgets.

As discussed in more detail in a later section, the state constitution requires authorized appropriations not exceed revenue estimates. To achieve this balance, the proposed budget with any necessary modifications may be further negotiated among legislative leaders and the Governor.

The final budget bill is then voted on by the full General Assembly. This typically occurs near the end of the session and before the beginning of the state fiscal year. However, if necessary, a special session may be convened after the regular session. The budget is then signed or vetoed by the governor. If signed, the budget is adopted and implemented. If the governor vetoes the budget, the legislature has the authority to override the veto with at least a two-thirds vote of each chamber.

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## **Budget Enactment**

Connecticut law has no specific provisions if a budget is not enacted before the start of the fiscal year. This situation has occurred twice in the last twelve years (1991 and 2003), each with different resolution.

**1991 budget process.** In 1991, the state went for over 50 days (from July 1 to August 22) without an adopted budget. The General Assembly passed three budgets (one during the regular session and two during the special session). Former Governor Lowell Weicker vetoed all three of these budgets. At that time, the legislature was reluctant to enact a state income tax that the governor concluded was the best way to deal with Connecticut's budget deficit.

On June 30, 1991 (the last day of the fiscal year), the state did not have an approved budget. On July 2, the governor announced a plan to cut back executive department services until a budget was enacted. Exercising his emergency powers, the governor shut down all but essential state services. In response, the General Assembly passed and the governor signed a series of continuing resolutions (appropriating funds for three two-week periods).

A few months later, the attorney general issued two formal opinions outlining the options available to the legislature and governor in a budget crisis. The attorney general advised the legislature to pass a continuing resolution to appropriate funds temporarily until a permanent budget could be adopted. Although the attorney general stated no specific authorization for this action exists, he concluded it was not needed because the state constitution authorizes the General Assembly to appropriate state funds.

Furthermore, the attorney general opinion also concluded that the governor is within his authority to veto any such measure and may issue an executive order to ensure continued essential and necessary government operations in the absence of a state budget.

According to the attorney general, the governor may issue executive orders in the exercise of his constitutional and statutory powers and

duties.<sup>8</sup> As such, the governor may issue an executive order authorizing the continuation of fiscal operations.

**2003 budget process.** Most recently, Governor John Rowland exercised executive authority to continue state spending for the fiscal year starting July 1, 2003. The governor consecutively issued four one-week executive orders finding a severe fiscal emergency due to the lack of an approved appropriations act. The orders directed all department heads and executive branch employees to limit expenditures to minimum and essential levels. The Governor's Office determines what are minimum and essential levels. On July 28, 2003, the governor issued a fifth executive order. However, unlike the other orders that had one-week expiration dates, the new order was to continue in effect until the end of the fiscal year or when a budget is adopted.

Prior to issuing the executive orders, the governor vetoed two biennial budget bills. To address the absence of a budget for the new fiscal year, the legislature passed a two-week continuing resolution on June 30, 2003. The governor vetoed this measure and challenged the legislative authority to enact it.

The legislature questioned the legality of the executive orders issued by the governor and requested a formal opinion from the state attorney general. On July 16, 2003, the attorney general issued an opinion restating the conclusions and options outlined in his 1991 memo.

Although the fact patterns were similar but not identical to the 1991 budget crisis, the attorney general found the temporary measures both legal and advisable. The legislature had the authority to override the governor's veto of the continuing resolution, but did not exercise it. In the absence of such an override and state budget, the governor has the authority to issue an executive order to ensure the continued essential and necessary government operations.

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## **OFA Budget Book**

The Office of Fiscal Analysis annually publishes a report on the budget as passed by the legislature known as the budget book. It provides detailed information on agency budgets including newly authorized expenditures, expenditure reductions, changes in taxes, and other revenue measures and

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<sup>8</sup> Under the state constitution, the governor is the supreme executive power in the state (Article Fourth §5) and must make sure state laws are faithfully executed (Article Fourth §12). Under Connecticut General Statute §3-1, the governor is also authorized to "personally or through any authorized agent, investigate into, and take any proper action concerning, any matter involving the enforcement of the laws of the state and the protection of its citizens."

bonding. Generally, OFA's budget book contains the following information:

- |                    |   |
|--------------------|---|
| <b>Overview</b>    | <ul style="list-style-type: none"><li>• Overview of previous budget and summary of the major changes made by the General Assembly in the last session</li><li>• Various tables showing significant budget data and revised spending cap calculations for each year of the biennium</li></ul>  |
| <b>Section I</b>   | <ul style="list-style-type: none"><li>• Schedule of general fund revenue</li><li>• Schedule of revenue for other appropriated funds</li><li>• Revenue changes made by legislation</li><li>• Revenue estimates for the biennium</li></ul>  |
| <b>Section II</b>  | <ul style="list-style-type: none"><li>• Individual state agency budget summaries with position summary, budget by program, and other resources available to the agencies (special non-appropriated funds, federal funds, and private funds)</li><li>• Historical information for each agency including:<ul style="list-style-type: none"><li>– Actual agency operating budgets for the previous fiscal year</li><li>– Estimated expenditures for the current year</li><li>– Governor's recommended figures for the biennium</li><li>– Legislative appropriations for the biennium</li></ul></li><li>• Explanation of budget changes and summary of significant legislation, if any, affecting an agency</li></ul> |
| <b>Section III</b> | <ul style="list-style-type: none"><li>• Capital budget with a summary of projects authorized in the last year's bonding legislation.</li><li>• Listing of all agencies' bond authorizations for the last year along with those unallocated balances remaining from previous years</li></ul>   |

OFA also publishes a budget revision book in the second year of the biennium. The format for revisions document is slightly modified but provides the same information. The agency operating budgets present actual expenditures for the prior year, estimated expenditures for the current year, the original appropriation, the governor's recommended revised amount, and the legislature's revised appropriation.

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## **Budget Bill Implementation**

Although the state's operating budget is primarily crafted in one bill (the appropriations act), its execution is often incorporated in a number of bills. As described above, the primary budget bill defines how much is to be spent by the state agencies on their various programs, services, and staff.

The budget bill also includes “back of the budget language”, which is literally text at the end of the budget bill providing legislative direction on other aspects of the budget. This language typically sets out what funds may be carried forward and for what purposes.

**Implementer bills.** The legislature enacts budget implementer bills that also provide greater detail on how funds in the appropriations act are to be spent. These bills are commonly referred to by the agency or department most affected, as in the “public health implementer” or the “Department of Social Services (DSS) implementer”. These bills make statutory changes to put into effect or “implement” the provisions of the adopted state budget.

There is no specified process for the development of the budget implementation bills. The number and content of the implementer bills is determined by legislative leadership and the governor. Budget implementers are sometimes viewed as vehicles for indirectly making policy changes after the appropriations act has been adopted.

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## **Allotment Process**

Appropriated funds are made available for expenditure through the allotment process administered by OPM’s Budget and Financial Management Division. Agencies receive quarterly allotments based on an annual spending plan submitted by the agency for review and the governor’s approval, prior to each July 1<sup>st</sup>. Once funds are allotted, the comptroller will encumber the funds upon the request of the state agency. The comptroller is responsible for keeping an account in connection with each appropriation and allotment.

The treasurer expends state funds at the direction of the comptroller. The comptroller must specify the particular appropriation against which funds must be drawn. No appropriation may be used for any purpose other than that for which it was made. Under state law, the governor may reduce allotments or appropriations due to changes in fiscal circumstances occurring after the budget was adopted.

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## **Budget Adjustments**

Occasionally, changes to the approved budget are necessary during a fiscal year to address revenue deficiencies. These changes may include transfer of funds within an agency or reduction of appropriated funds. The following describes some common adjustment practices.



**Allotment restriction/rescission.** The allotment of appropriated funds may be restricted if the governor determines estimated budget resources will be insufficient to finance appropriations in full. The governor must file a report with the Appropriations and the Finance, Revenue and Bonding Committees that describes the fiscal exigency or the basis for his determination that resources will be insufficient to fund full appropriations. OPM must submit copies of the reductions and the reasons for them to state agency heads, the comptroller, and the Appropriations Committee, through the Office of Fiscal Analysis.

In addition, the governor must also restrict allotments if the comptroller's monthly financial statement projects a deficit greater than 1 percent of total general fund appropriations. The governor is authorized to restrict allotments within specified limits (up to 5 percent of an individual appropriation account within an agency, but not more than 3 percent of total appropriations in a fund).

The governor may reduce overall appropriations more than 3 percent with the Finance Advisory Committee (FAC) approval. The FAC is a joint legislative-executive body composed of: the governor, lieutenant governor, treasurer, comptroller, and two senate members (not more than one from the same political party) and three house members (not more than two from the same political party) of the Appropriations Committee. A reduction of more than 5 percent of the total appropriations from any fund requires legislative approval.

**Governor's expanded rescission authority.** Section 52 of P.A. 02-1 (May Special Session) temporarily expanded the governor's rescission authority in FY 03. The law allows the governor to make more extensive cuts than normal in FY 03 budget appropriations after October 1, 2002, if he determines:

- immediate action is needed; or
- the state will not be able to fully fund all appropriations; and
- his existing authority to make cuts is not enough to remedy the situation.

For FY 03, the governor could reduce total appropriations from any fund or any line item by an extra 5 percent for a total of 8 percent from any fund and 10 percent from any line item. His authority is limited to \$35 million in total, and he cannot cut the following grants:

- Educational Cost Sharing;
- Town Road Aid;
- Payment in Lieu of Taxes (PILOT) - College and Hospital; and
- Payment in Lieu of Taxes (PILOT) – State Owned Property.

The act suspends the requirement that the governor obtain FAC approval for budget reductions carried out under his expanded authority.

**Transfers.** When an appropriation is insufficient to pay the expenditures required to meet the purposes for which the appropriation was made, the governor may, at the request of the head of the budgeted agency, transfer funds from other specific appropriations of the agency in amounts the Governor feels necessary to meet the expenditures.

FAC approval is needed for any transfers exceeding 10 percent of the original appropriation or \$50,000, whichever is less. Any adjustments or transfers of funds from one appropriation account to another must be requested through OPM's Budget and Financial Management Division. Notification of all transfers must be provided to the Appropriations Committee through the Office of Fiscal Analysis. Appropriations transfers between departments are also allowed if a legislative act transfers duties.

**Carry forwards.** If an agency does not spend its total appropriated funding within a fiscal year, the unspent balance may in some instances be "carried forward" for spending the next fiscal year. The amount that can be carried forward from one fiscal year to the next, and the purposes for which the funds may be used, are defined in statute or legislation.

Any amount not specifically defined to be carried forward must be returned to the General Fund and be re-appropriated to a program through the general budget process. If funds are carried over from one year to the next, they only count against the spending cap limit in the year they were originally budgeted.

**Deficiencies.** Every year some agencies exceed their appropriations. The legislature may approve deficiency bills to cover these shortfalls through a combination of new appropriations, reduced appropriations in other accounts, and fund transfers.

On or before the 25<sup>th</sup> day of each month, OPM must submit a list of appropriation accounts in which a potential deficiency exists along with an explanation. The report must be sent to the governor, the comptroller, and the Appropriations Committee through OFA.

Every year as part of the governor's budget or status report delivery, OPM must present the items to include in a deficiency bill to pay the expenses of the current fiscal year of the biennium. The items must be presented to the treasurer and the appropriations committee through OFA for legislative consideration. Agencies with deficiencies must also submit a report indicating the steps taken to reduce or eliminate the deficiency.

**Lapses.** It is annually anticipated that each state agency will not actually spend all the money appropriated to it. The unexpended portion of an appropriation remaining at the end of a fiscal year is called a lapse. Each agency's budget has a certain amount of built-in lapse.

There are administrative and program lapses. For example, an administrative lapse may occur when staff positions remain unfilled. A program lapse may result when there are delays in program startup or caseloads decline.

These savings can be applied to cover deficiency shortfalls in other areas. Because using lapses to cover deficiencies results in spending that does not have to be appropriated, it is not counted toward the calculation of the spending cap.

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## IV. Requirements and Constraints

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Economic conditions and political considerations have a major impact on the state budget process. In addition, several of Connecticut's key budgeting practices are required by law, instituted as part of the state's 1991 fiscal reform package. The three main statutory budgeting requirements -- the cap on state spending, the balanced budget provisions, and the mandatory Budget Reserve Fund -- are described below.

Additional factors that can constrain state spending decisions indirectly are also highlighted in this section. These include the availability of federal funds, the state's capital budget and level of bonded debt, court actions, and collective bargaining agreements.

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### Spending Cap

The state budget has been subject to a statutory spending cap since 1991. This cap limits the annual growth in state spending. The increase in "general budget expenditures" cannot be more than the greater of: 1) the five-year average in growth of Connecticut's "personal income" or 2) the 12-month rate of inflation as measured by the consumer price index.<sup>9</sup> This cap may only be exceeded by the governor's emergency declaration and supported by a three-fifths majority vote of both legislative chambers.

The spending cap provisions were included in the state's constitution in November 1992. The constitutional cap required the legislature to adopt statutory definitions. To date, the legislature has not defined the terms necessary to implement the constitutional cap. An attorney general opinion issued in 1993 concluded that the statutory cap remains in place until the legislature adopts definitions for the constitutional cap. Any definitions must be approved by a three-fifths majority of the legislature.<sup>10</sup>

At present, spending cap calculations apply to the state's 10 appropriated funds and are based on "general budget expenditures," which cover all state spending with certain statutory exemptions. Exempt or "non-capped" expenditures include:

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<sup>9</sup> The state's personal income growth is determined by the U.S. Bureau of Economic Analysis. The increase in inflation is determined by the U.S. Bureau of Labor Statistics.

<sup>10</sup> In September 1993, a state legislator sued the legislature for not implementing the constitutional cap. The case was eventually dismissed by the state Supreme Court in January 1996. In October 1993, the Federation of Connecticut Taxpayers pursued this issue in federal district court claiming state fiscal officers violated the spending cap. The court dismissed the case for lack of subject matter jurisdiction. This decision was upheld by the U.S. Court of Appeals in June 1995.

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- payment of the principal of and interest on bonds, notes, or other evidences or indebtedness;
- expenditures from the Budget Reserve Fund;
- statutory grants to distressed municipalities; and
- first year expenditures for the implementation of federal mandates or court orders.

Subtracting the total amount spent on the exempt areas from the previous year's appropriated funds constitutes the spending cap base. The base is then multiplied by the allowable growth rate (personal income or inflation). The result is the dollar amount that the budget may grow unless the governor and the legislature agree to exceed the cap. Actual capped expenditures and allowable growth for four fiscal years are shown in Table 9.

<b>Table 9. Historical Spending Cap Calculation</b>				
	<b>FY98</b>	<b>FY99</b>	<b>FY00</b>	<b>FY01</b>
<b>Capped Budget Expenditures</b>	\$8,070,800,000	\$8,404,500,000	\$8,821,200,000	\$9,216,100,000
<b>Growth Factor (Personal Income)</b>	3.97%	4.86%	5.08%	5.48%
<b>Allowable Growth</b>	\$320,410,760	\$408,458,700	\$448,116,960	\$505,042,280
Source of Data: Office of Fiscal Analysis				

In summary, the statutory spending cap calculation is:

$$\begin{aligned} \text{Base} &= (\text{Prior year's appropriated funds} - \text{exemptions}) \\ \text{Allowable spending increase} &= (\text{Base} \times \text{allowable growth rate}) \end{aligned}$$

According to OFA, the spending cap has been exceeded by: \$194.5 million in FY 98, \$525.7 million in FY 99, \$498.3 million in FY 00, and \$608.1 million in FY 01. Each time, the governor issued a declaration of the existence of extraordinary circumstances to allow for the statutory cap to be exceeded, and the legislature supported it with at least a three-fifths vote. The most recently published OFA budget book shows appropriations for FY 02 and FY 03 were under the spending cap by \$78.17 million and \$363 million, respectively.

## Balanced Budget Requirement

The 28<sup>th</sup> amendment of the Connecticut constitution adopted in 1992 requires that the state budget be balanced -- projected expenditures cannot exceed revenue estimates. This requires that the spending approved by the legislature's Appropriation Committee must be reconciled with the Finance, Revenue, and Bonding Committee's proposals and revenue estimates. If the figures do not match, legislative leaders must work with the governor to achieve a balance by adjusting spending or changing revenue.

**Surplus/deficit.** A budget surplus is created when actual revenues exceed projected revenues by a greater amount than actual expenditures exceed the budgeted expenditures. Conversely, when actual revenues collected in a given fiscal year fall below projected revenues without a corresponding decline in actual expenditures, a budget deficit occurs.

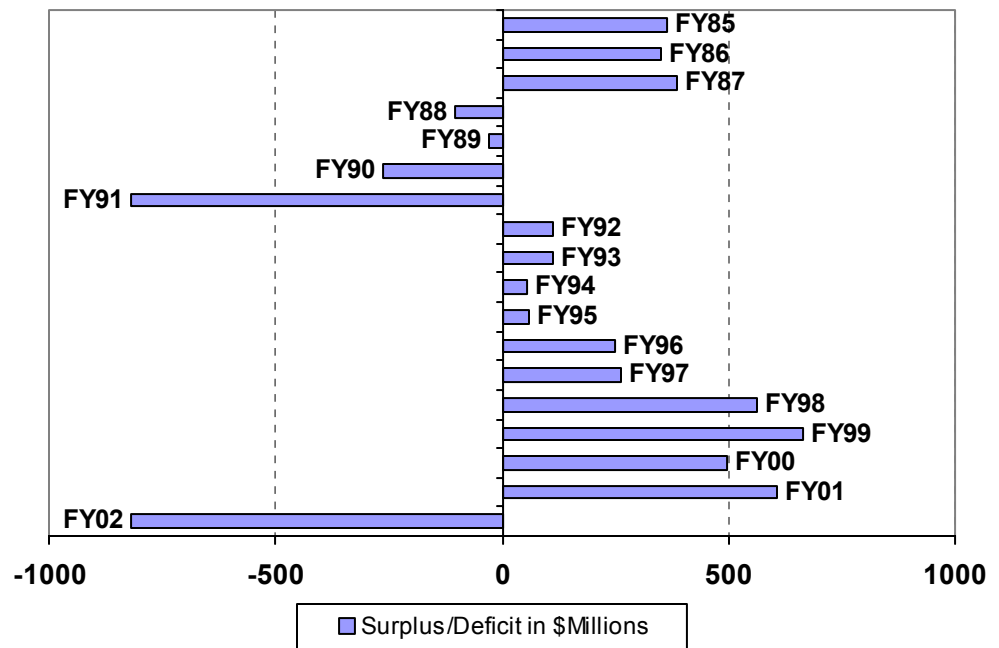
At the close of the fiscal year, the comptroller determines any unappropriated surplus. The state constitution (Article III Section 18 (c)) requires a three-fifths vote to authorize use of an unappropriated surplus for purposes other than to fund a budget reserve fund or reduce the state's bonded indebtedness. As discussed above, the treasurer is required to transfer any surplus to the Budget Reserve Fund.

Connecticut budget balances from FY 85 through FY 02 are shown in Figure 4. At the end of FY 02, the General Fund had an operating deficit of approximately \$817.1 million. The Budget Reserve fund was depleted in part from a transfer of \$594.7 million to cover the deficit. The remaining deficit of \$222.4 million was financed through an Economic Recovery Debt Retirement fund established in 2002 by Special Act 02-1 (May 9 Special Session).

The act provided General Obligation tax-exempt notes would be issued and financed over a five-year period. No principal would be paid in the fiscal year of issuance. In addition to the \$222.4 million principal payment, interest costs are estimated at \$23.4 million for a total payment of \$245.8 million.

Surplus expenditures, historically, are not added to the base going forward to calculate the state spending cap in subsequent years. The governor is permitted to declare in his statement of emergency or the existence of extraordinary circumstances whether any portion of surplus expenditures will be counted in the base for the next year. This option has not been exercised to date.

**Figure 4. General Fund Budget Balance Over Time**



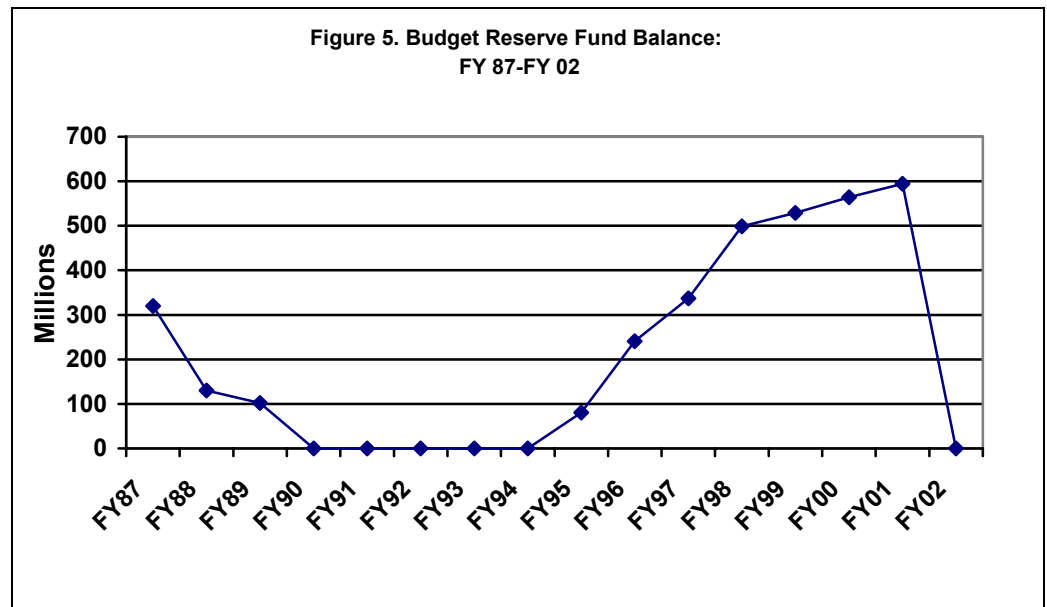
## Budget Reserve Fund

State law establishes a Budget Reserve Fund, more commonly known as the rainy day fund, to maintain up to 10 percent of the net general fund appropriations to handle unanticipated deficits. The fund can only be used to finance state operating deficits at the end of the fiscal year. It cannot be used to balance a proposed budget for the coming fiscal year. By law, once the fund reaches the maximum 10 percent, the treasurer is not required to transfer additional unappropriated General Fund surpluses to it.

Any end-of-year budget surplus replenishes the Budget Reserve Fund. Surpluses that exceed the maximum amount allocable to the reserve fund must be used to reduce the State Employees Retirement Fund's unfunded liability and outstanding state debt.

Fund balances over time according to OFA are shown in Figure 5. As the graph shows, the fund has served its intended purpose. The fund, built up in the mid 80s, was used during the economic downturn in the early 90s. The mid 90s saw the fund restored and then depleted by the most recent fiscal crisis.





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## Other Constraints

**Federal funds.** Another factor that impacts the state budget is the availability of federal funds. Connecticut receives federal funds through a variety of agencies and programs. Most federal funds are deposited into the state's General Fund as revenue. According to the most recent comptroller's economic report, Connecticut receives approximately 24 percent of its funds from the federal government.

Federal funds may be connected to entitlement programs, may have a matching fund requirement, be formula driven, or competitive. The federal government provides partial reimbursement for certain services the state funds such as Medicaid. Connecticut receives federal reimbursement if the programs and services comply with federal statutes and regulations that establish them.

Often federal money comes to states through block grants for various broad purposes. Typically, block grants have federal guidelines defining target populations and uses of funds. Spending plans for the block grants must be approved by the relevant legislative committees. In addition, Connecticut may also receive single purpose grants. The use of these funds is generally limited.

Many federal grants often require some form of funding match. The matching amount can vary by program or grant. In some programs, the state match is "open-ended" in that there is no limit to the amount of federal funds that can be accessed. There are also "closed-ended"

programs requiring a match but limit the state's availability to federal funds by either some caseload measure or fixed dollar amount.

During the 2003 legislative session, legislation intended to promote maximization of federal funding was adopted but vetoed (P.A. 03-157). The act would have required OPM, in consultation with OFA, to develop a plan to increase the level of federal funds available to the state. The act also required each state agency to annually assess and report on the amount of federal funds it actually and potentially may receive. The report, which was to be submitted to OPM, OFA, and the legislature's Appropriation Committee, was to include an assessment and explanation of federal funds available but not accessed by the agency.

The governor vetoed this public act indicating it unnecessarily used state resources to accomplish a task already performed. The governor also stated the act did not give the legislature any more information than it currently receives or could gather through the existing process.

**Bonding.** Connecticut, through the state treasurer, borrows money to finance public programs by periodically issuing bonds. This allows the state to spread out the costs of major projects rather than funding them in a single fiscal year. On occasion, the state has also used bonding to provide funds to municipal, business, and non-governmental entities through grants and loans. Connecticut has also extended its credit backing to bonds issued by certain quasi-public bond-issuing authorities.

The accumulation of debt can place constraints on the state's budget by requiring high annual debt service (principal and interest) payments. As a fixed cost, debt service cannot be easily adjusted when state revenue growth declines and budget deficits are projected.

**Federal and state court orders.** Another challenge to the development of the state budget is issuance of state and federal court orders. Compliance with court orders is mandatory and frequently requires the appropriation or re-allocation of funds. Often, court orders continue to complicate budgetary decisions for years.

By law, for purposes of the state spending cap, expenditures for the implementation of federal mandates or court orders are not to be considered general budget expenditures for the first fiscal year in which such expenditures are authorized. However, they must be considered as expenditures in the ensuing fiscal years.

**Collective bargaining.** Financial obligations required by collective bargaining agreements are another consideration in the formulation of the state budget. State law requires parties to a collective bargaining

agreement between the state and a state employees' union to file with the House and Senate clerks the agreement, a request for funds to implement it, and a request for approval of any provision that conflicts with a statute or regulation.

The legislature must consider the funding or any contract terms in conflict with statutes or regulations within 30 days after the agreement is received.<sup>11</sup> If the legislature takes no action, the agreement is deemed approved once the 30-day period expires. If the General Assembly rejects the agreement, the parties must resume negotiations.

By law, the terms of the collective bargaining agreement or arbitration award approved by the General Assembly prevails over any state statute, special act, or state agency regulation covering collective bargaining matters. These include state employee personnel matters such as wages, hours, and conditions of employment under the state personnel act and the state employee retirement laws.

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<sup>11</sup> The 30-day period does not begin unless the General Assembly is in regular session. If the legislature is not in session, the agreement must be submitted within 10 days of the first day of the next regular session or special session called for such purpose.



## V. Findings & Recommendations

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### Overview

The formal process established to prepare Connecticut's operating budget incorporates most of the widely recognized best practices for budgeting. Key rules for achieving a balanced budget -- a constitutional balanced budget requirement, a statutory cap on spending, provisions for a rainy day fund, and mechanisms for controlling spending during the fiscal year - - were put in place as part of Connecticut's 1991 financial reform package. Additional reforms included a biennial budget cycle and performance measurement, mechanisms aimed at focusing funding decisions on results and long-term outcomes.

**Summary of findings.** The program review committee found the goals of the 1991 budget reforms have been achieved in part. Over the past ten years, increases in state spending have been curbed, deficits have been avoided or mitigated, and surpluses have been applied primarily to one-time purposes including filling the Budget Reserve Fund. In most years, a budget has been in place before the start of the fiscal year.

At the same time, there is not always strict adherence to required procedures or recommended financial management policies. There has been little progress in developing information about program results for budgeting purposes and biennial budgeting has not been implemented as expected. In addition, the last two budget cycles have been less than successful in terms of adopting a balanced budget in a timely manner.

A major factor contributing to recent budgeting problems in Connecticut as well as in most other states is a poor economy. Connecticut's divided government -- a legislature controlled by one party and an administration controlled by another -- compounds the difficulty in reaching decisions on how to balance the budget with fewer resources and growing needs.

**Proposed improvements.** While economic and political conditions present challenges to effective budgeting, the committee study did identify ways to make the process work better and improve decision making. The program review committee concluded recently encountered problems could be eased in the future with better information, greater participation, and more transparency in the process. Committee recommendations designed to promote these results are discussed in this chapter.

An assessment of the state's most critical practices for balancing the budget and controlling spending is presented first. The committee found current rules governing the process are effective for the most part when there is a commitment to follow them. Some modifications to strengthen existing provisions are proposed. The program review study also identified ways to improve the decision making process by expanding the scope of financial information available to legislators, promoting a

stronger link between funding and results, and establishing a better process for setting spending priorities.

In any state, decision makers need to find the balance between rules and discretion to promote the best decisions for allocating public resources. By design and necessity, the budget process requires negotiation and compromise between the executive and legislative branches, political parties, and individual legislators concerned about a vast array of issues and interests.

Although each legislator may influence the budget to some degree, few are in a position to insure outcomes are entirely to his or her liking. Further, the governor always has the authority to veto the budget put forward by the legislature. No budget will ever satisfy everyone and conflicting expectations are bound to lead to dissatisfaction with the final product. Connecticut's current fiscal crisis and partisan divisions have intensified conflicts in the process that can end in either accommodation or deadlock.

There are no simple solutions to these problems. Much of the success of the budgeting process depends on the will of all involved to adhere to good practices. The committee study took a broad view of the state budgeting process, with the aim of highlighting the major strengths and weaknesses of system and focusing future discussion.

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## Balanced Budget

An overriding goal for any budgeting process is to balance expenditures and revenues. Connecticut has a constitutional balanced budget requirement that prohibits the state from authorizing general budget expenditures in excess of the amount of estimated revenue for a fiscal year. *There has been compliance with this requirement every year since it went into effect in 1992.*

*At times, the balance reflected in the appropriations act adopted by the legislature has been short-lived and achieved through less than optimal financial management practices.* For example, to balance the budget for the current biennium, extensive use was made of one-time revenue sources.<sup>12</sup> In another case, expenditures for FY 03 were balanced against an unrevised revenue projection.<sup>13</sup>

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<sup>12</sup> The FY 05 budget includes almost \$400 million in one-time revenue sources including transfers from special funds and projected revenue from securitizing the state's tobacco settlement funding.

<sup>13</sup> In 2002, the Finance committee did not adopt a new FY 03 revenue estimate to update the figure included in the original budget of the 2001-03 biennium.

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The two most recently completed fiscal years ended in deficits (\$222.4 million in FY 02 and \$96.7 million in FY 03) despite legislative and executive efforts to avoid shortfalls including the use of revenue enhancements, spending cuts, and depletion of the rainy day fund. To achieve a final balance, the decision was made to carry the year-end deficit into the next fiscal year and finance it with short-term bonding.

Whether spending matches revenues over the long term and without financial “quick fixes” is a critical consideration for bond rating agencies assessing a state’s creditworthiness. One effective curb on short-term fixes like bonding operating deficits, overusing one-time revenue sources, and manipulating spending or revenue estimates is the negative reaction of agencies that rate state bonds.

In interviews with committee staff, representatives from three major rating agencies (Fitch, Moody’s, and Standard & Poor) noted many states resorted to short-term fixes to balance their budgets during the recent economic downturn. Generally, this is not a serious concern if such devices are used for only a limited time and there is evidence of long-term corrective action.

The rating agencies also reported states with the highest bond ratings (AAA) have: structural balance (revenues match expenditures on an on-going basis); good forecasting (projections are reasonable and accurate); quick responses to shortfalls; and the tools and discipline to keep their budgets in balance.

*For the most part, Connecticut’s budgeting procedures are viewed as average or better, and its relatively high bond ratings reflect that perspective.* At present, the state’s general obligation bonds are rated in the second highest tier by all three agencies (i.e., Fitch: AA; Moody’s: Aa3; and Standard & Poor’s: AA Stable).

One factor that contributes to good ratings is effective expenditure controls. As outlined in the briefing report, in addition to the constitutional balanced budget requirement, Connecticut has a cap on general budget spending, discussed in the next section, and several statutory provisions aimed at controlling spending during the fiscal year.

Expenditures and revenues are continuously monitored for spending control purposes by the Office of Policy and Management and the comptroller. By statute, if it is determined estimated budget resources will be insufficient to fully finance all appropriations, the governor is authorized to reduce spending within certain limits. In addition, if the comptroller’s monthly financial report project a General Fund deficit greater than 1 percent of total appropriations, the governor must file a report with the legislature that includes a plan for preventing the deficit.

The program review committee found *the governor, as required, has reduced appropriations and transferred funding, with approval by the Finance Advisory Committee (FAC) when necessary, to maintain a balanced budget.* In addition, to address deficits reported by the comptroller, mitigation plans have been developed and implemented as mandated, with both executive and legislative action. The most recent deficit mitigation plan was put into effect in February 2003.

During the past two legislative sessions, the General Assembly also temporarily expanded the governor's rescission authority through provisions contained in the appropriations act. As Table 10 outlines, the legislature authorized the governor to further reduce appropriations by up to \$35 million, within certain limits, for FY 03 and to make cuts totaling up to \$55 million in the FY 04 budget. In both cases, the reductions are not subject to FAC approval or further legislative review.

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**Table 10. Summary of Governor's Expanded Rescission Authority**

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<u>FY 03 (P.A. 02-1)</u>	<u>FY 05 (P.A. 03-1)</u>
<p>The governor can reduce total appropriations from any fund or any line item by an extra 5 percent for a total of 8 percent from any fund and 10 percent from any line item, up to a limit of \$35 million. However, the following grants can not be cut:</p> <ul style="list-style-type: none"> <li>• Educational Cost Sharing;</li> <li>• Town Road Aid;</li> <li>• Payment in Lieu of Taxes (PILOT), College and Hospital; and</li> <li>• Payment in Lieu of Taxes (PILOT), State-Owned Property.</li> </ul>	<p>The governor can make up to \$55 million in expanded rescissions on or after October 1, 2004, not to exceed an additional 5 percent of any appropriation or fund beyond his current authority but no specific areas are exempt.</p> <p>Further, if the state is certified to receive \$55 million or more of federal aid in FY 2005 the extraordinary rescission authority is repealed. If the federal aid is less than \$55 million, the governor may use the extraordinary authority to rescind only an aggregate of the difference between that amount and \$55 million.</p>

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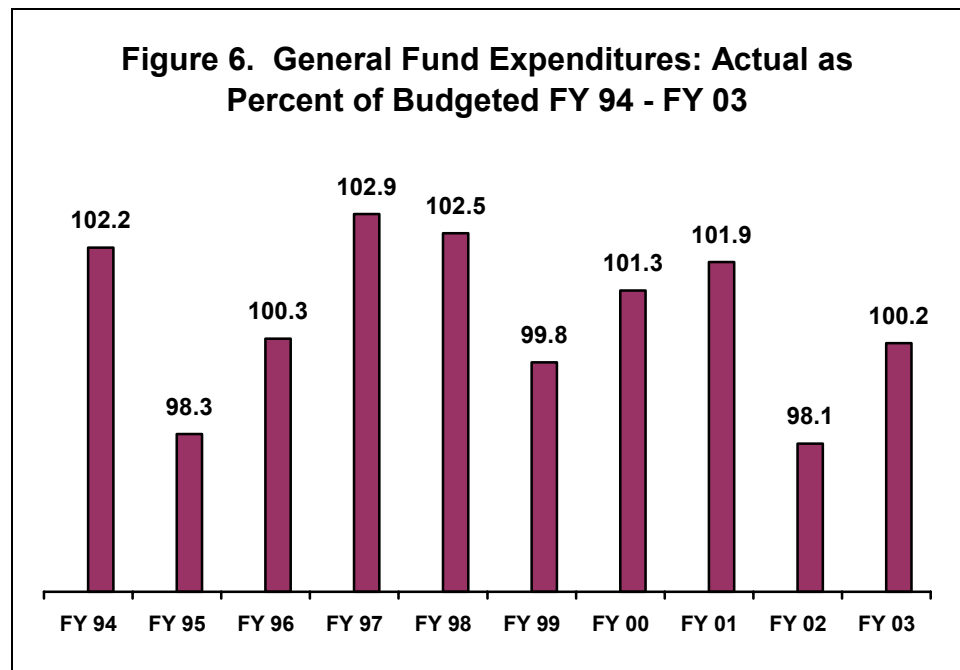
The program review committee recognizes the expediency of allowing the governor expanded authority to act quickly to forestall deficits through spending cuts. However, *giving the executive authority for such significant reductions without legislative review raises questions about the balance of control over spending policy.*

Legislators from both parties interviewed by committee staff were in agreement that the expanded rescission authority was not a good practice and several labeled it an abdication of legislative authority. It was



generally believed the decision to expand the governor's authority is not a systemic problem but a reflection of the stress of the fiscal crisis and a divided government.

**Spending control outcomes.** *Overall, the state's system for controlling the spending side of the budget appears to keep actual expenditures fairly close to authorized levels.* Figure 6 shows actual expenditures as a percentage of budgeted spending since FY 94. As the figure indicates, actual expenditures have differed from the amount budgeted by 3 percent or less over the 10-year period. In dollar terms, the differences were represented from just under \$19 million to about \$262 million.



In the same period, fluctuations in General Fund spending levels due to budgeted lapses (expected savings) and deficiencies (unbudgeted cost increases) have been relatively small and steady. Over the past 10 fiscal years, actual lapsed spending as a portion of the total budget averaged 1.7 percent (\$166.0 million annually) and ranged from 0.8 to 3.0 percent. Budgeted savings within the General Fund have been achieved or exceeded each year, averaging 90.5 percent of actual lapsed spending since FY 94.

General Fund deficiency funding, which includes new appropriations and transferred funding for unanticipated cost increases during a fiscal year, has also been nominal and steady. Deficiencies averaged less than one percent of original net appropriations (\$72.2 million) and ranged from 0.1 to 1.5 percent during this 10-year period.

*In recent years, it appears revenues have had more influence than expenditures on the state's budget balance. An OFA analysis conducted in 2002 found the biggest contributor to the final balance of the General Fund from FY 98 through FY 02 was fluctuations in revenue collections rather than actual expenditures.<sup>14</sup> The following table, which summarizes the data examined by OFA, shows the difference between realized and estimated revenue was a much larger factor in the amount of budget surplus or deficit than over or under spending.*

**Table 11. General Fund Balance: Contributions of Spending and Revenue  
FY 98 – FY 02 (dollars in millions)**

	FY 98	FY 99	FY 00	FY 01	FY02
<b>Budgeted Balance</b>	\$ 0.2	\$ 19.9	\$ 64.4	\$ 0.5	\$ 0.1
<b>Actual Balance: Surplus/(Deficit)</b>	\$ 562.2	\$ 663.0	\$ 496.8	\$ 606.9	\$ (817.1)*
<b>Spending Above/ (Below) Budgeted</b>	\$ 238.0	\$ (18.7)	\$ 135.2	\$ 97.8	\$ (231.5)
<b>Revenue Above/ (Below) Budgeted</b>	\$ 800.0	\$ 624.4	\$ 567.6	\$ 704.2	\$ (1,048.7)

\* Deficit prior to transfer of Budget Reserve Fund monies.

Source of Data: OFA, December 2002

The OFA analysis underscores the importance of accurate revenue estimates as well as effective spending controls to a balanced budget. It also points out the challenges a volatile economy presents for revenue forecasting.

## Revenue Forecasting

Revenue forecasting for budgetary purposes is carried out for the legislature by the nonpartisan Office of Fiscal Analysis. The process OFA uses to monitor and project state revenues incorporates the key elements recommended by the Government Finance Officers Association. These include using a variety of data sources to develop estimates, examining each component of the revenue stream, comparing results with other forecasts, regularly monitoring and periodically updating projections, and extending projections out for several years.

<sup>14</sup> OFA, *Overview of the State Budget Process*, December 10, 2002, p.25

The Office of Policy and Management carries out the revenue forecasting function for the executive branch using a similar process. The OPM and OFA staff responsible for revenue forecasting do share information and sometimes confer on estimates. Unlike some states, however, an official consensus estimate is not developed and adopted by the executive and legislative branches.

Under state law, the statement of estimated revenue that must be contained in every budget is provided by the legislature's finance committee. The committee's estimate is prepared with the advice and assistance of the Office of Fiscal Analysis. Budget estimates of revenue since FY 94 are compared with actual realized revenues in Table 12. Information for FY 03 is not included in the table since, as noted earlier, the finance committee did not adopt a revised estimate for that year.

**Table 12. General Fund Revenues: Actual and Estimated  
FY 94 – FY 02 (dollars in millions)**

	<b>FY 94</b>	<b>FY 95</b>	<b>FY 96</b>	<b>FY 97</b>	<b>FY 98</b>	<b>FY 99</b>	<b>FY 00</b>	<b>FY 01</b>	<b>FY 02</b>
<b>Actual</b>	\$7,914.1	\$8,479.6	\$9,111.1	\$9,582.0	\$10,142.2	\$10,616.4	\$11,213.6	\$11,985.5	\$10,845.4
<b>Est.</b>	\$7,695.3	\$8,571.2	\$8,837.0	\$9,049.7	\$9,342.4	\$9,992.0	\$10,646.0	\$11,281.3	\$11,894.1
<b>Diff.</b>	\$ 218.8	(91.6)	\$ 274.1	\$ 532.3	\$ 799.8	\$ 624.4	\$ 567.6	\$ 704.2	\$(1,048.7)
<b>Pct.</b>									
<b>Diff.</b>	2.8%	-1.1%	3.1%	5.9%	8.6%	6.2%	5.3%	6.2%	-8.8%

Source of data: OFA End of Year Reports

The table shows state revenue estimates have varied from realized revenues by as little as 1.1 percent to almost 9 percent. The larger differences between estimated and realized revenues in fiscal years 97 through 01 reflect, in part, the conservative forecasting approach many states adopted during this period of unprecedented economic growth. Similarly, the volatility of the economy following September 11, 2001, made accurate revenue estimates a challenge for all forecasters.

Information comparing state forecasts with actual economic performance was compiled by the National Association of State Budget Officers in 2002. The results of the NASBO study showed Connecticut was neither the best nor the worst in terms of the accuracy of its main revenue projections. Connecticut ranked 23<sup>rd</sup> of the 29 states rated regarding percentage point change in state GDP forecasts, 13<sup>th</sup> of the 37 states rated regarding percentage point change in state personal income forecasts, 23<sup>rd</sup> of the 45 state rated on the percent difference between projected and

collected sales tax, and 18<sup>th</sup> of the 42 states rated on the percent difference between projected and collected personal income tax collections.<sup>15</sup>

*The legislature's current revenue forecasting process appears adequate. It includes most recommended best practices and has had at least average results in terms of accuracy.* As the scope of this study is limited to the expenditure side of the budget, the program review committee did not conduct an in-depth evaluation of this revenue-related issue. However, additional research might reveal possible improvements.

The committee did identify one problem with the process that is within the current study scope -- the timing of the legislature's revenue estimate. At present, the official revenue estimate is considered and adopted by the finance committee after the appropriations committee has prepared the state's spending bill.

Connecticut does not, as GFOA recommends, combine forecasting of revenues and expenditures into a single financial forecast. In addition, *while the underlying assumptions and methods for the revenue estimate are presented at a finance committee meeting, this occurs late in the budget process with a limited audience.* A mechanism for more thorough legislative consideration of revenue and expenditure forecasts earlier in the process is discussed below in the section concerning setting priorities.

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## **Use of Surplus**

At the close of each fiscal year, the comptroller certifies the state's budget balances. If revenues exceed the actual expenditures, a surplus results. Provisions of the state constitution and statutes direct the use of surplus funds, but allow the legislature some discretion. By law, unappropriated surplus funds must be used to replenish the Budget Reserve Fund, eliminate debt service, address pension liabilities, and any other purpose approved by a three-fifths majority vote of the legislature.

Specifically, Connecticut Constitution Article III Amendment XXVIII Section 18 (c) states: "Any unappropriated surplus shall be used to fund a budget reserve fund or for the reduction of bonded indebtedness; or for any other purpose authorized by at least three-fifths of the members of each house of the general assembly." Connecticut General Statutes § 4-30a states any unappropriated surplus must be transferred to the Budget

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<sup>15</sup> See *State Policy Reports*, Vol. 20, Issue 13, July 2002, pp. 7- 16.

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Reserve fund up to its required 10 percent level of net appropriated funds followed by State Employees Retirement Fund and then debt service.<sup>16</sup>

Beginning in the mid-1990s, the strong economy provided Connecticut with substantial surpluses at the end of each fiscal year. As Table 13 shows, Connecticut enjoyed close to \$3 billion in surplus funds during fiscal years 95 through 01.

The program review committee found *the surplus funds have been used for the purposes outlined by state law*. As directed, the funds were used to build up the Budget Reserve Fund to its maximum balance as well as to retire and avoid bonded debt.

**Table 13. Use of Surplus: FY95 – FY 01(dollars in millions)**

	FY 95	FY 96	FY 97	FY 98	FY 99	FY 00	FY 01*
<b>Total Surplus</b>	\$80.5	\$250.0	\$262.6	\$562.2	\$663.0	\$496.8	\$606.9
<b>Appropriated Uses</b>				\$249.3	\$591.2	\$196.4	\$292.1
<b>Debt Retirement/Avoidance</b>		\$89.5	\$166.7	\$151.2	\$41.3	\$265.5	
<b>Budget Reserve Fund Deposit</b>	\$80.5	\$160.5	\$95.9	\$161.7	\$30.5	\$34.9	\$30.7

\* Lower than anticipated revenue significantly reduced the amount of surplus available for appropriation (i.e., from \$ 576.2 to \$292.1 million.)

Source of data: OFA

In the years when the surplus reached over \$500 million, funds were used for a wide variety of other purposes approved by a three-fifths majority vote of the legislature. These uses included: tax rebates, information technology upgrades (e.g., Y2K related costs), payment of the state's 27<sup>th</sup> payroll in FY 99, municipal redevelopment (e.g., the UCONN stadium project), payment of state employee health claims, and aid for a wide assortment of programs (e.g., arts, hospitals, local school construction and technology, open space, and supported housing).

The committee also found *the appropriated uses of the state's surplus were made primarily for one-time purposes, consistent with recognized best financial practices*. Surplus funds represent temporary improvement of a state's financial condition. As such funding is usually not sustainable, it should not be considered for on-going programs and operating costs.

<sup>16</sup> There may be a conflict about how surplus must be used under the constitution and by statute. The potential impact of this conflict is unclear.

However, a portion of the appropriated surpluses has been applied to on-going costs. The amount is not readily identifiable. According to OFA estimates, in FY 00 the amount of surplus funding used for on-going purposes was \$46.4 million, in FY 01 the amount was \$51.7 million, and not more than about \$50 million of surplus appropriation was applied to on-going purposes in FY 02.

The committee finds *the state's use of surplus funds for on-going purposes has not been extensive but should be closely monitored*. A mechanism for permitting closer examination of the use of surplus funds is included in a later recommendation concerning setting spending priorities.

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## Budget Reserve Fund

One practice that can help mitigate budget shortfalls during recessions is building up surpluses in good economic times. Almost all states have formal budget stabilization funds also known as budget reserve or rainy day funds. Budget experts and bond rating agencies both favorably regard this practice.

Since 1978, Connecticut has maintained its budget reserve fund as a tool for dealing with changes in revenue projections and unforeseen emergencies. This fund currently is required to maintain up to 10 percent of net General Fund appropriations to handle unanticipated deficits. It can only be used to finance state operating deficits at the end of the fiscal year. It cannot be used to balance a proposed budget for the coming fiscal year.

*A review of the recent history of Connecticut's Budget Reserve Fund balances indicates the state has done fairly well in managing the fund since fiscal reforms. As Table 14 shows, surplus has been used to fill the rainy day fund since 1995. The fund reached its then 5 percent statutory requirement for the first time in FY 99. Additional funds were subsequently added as needed to maintain the level. However, the fund was completely depleted in 2002 by a single year's deficit.*

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**Table 14. Budget Reserve Fund (dollars in millions): FY 95- FY02**

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	FY 95	FY 96	FY 97	FY 98	FY 99	FY 00	FY 01	FY 02
<b>Deposit</b>	\$ 80.5	\$160.5	\$ 95.9	\$161.7	\$ 30.5	\$ 34.9	\$ 30.7	\$ 0.0
<b>Balance</b>	\$ 80.5	\$241.0	\$336.9	\$498.6	\$529.1	\$564.0	\$594.7	\$ 0.0

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Source of data: OFA , *Connecticut Revenue & Budget Data*, March 2002

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For many years the fund was only required to maintain a 5 percent balance, which at the time was considered by most experts as adequate

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and average compared to other states. The level was increased to 10 percent earlier this year.

This level is in line with the current Government Finance Officer Association recommended practice of maintaining no less than 5 to 15 percent of operating revenues or no less than one to two months of regular general fund operating expenditures. Recent studies suggest fund size should be correlated with budget volatility. States with greater budgetary volatility are likely to need larger reserve amounts while smaller funds might be sufficient for more stable states.

*It is not clear whether Connecticut's newly increased 10 percent level is adequate.* What is clear is the state's financial condition and current deficit would be far worse without a rainy day fund. The Budget Reserve Fund is not a panacea but it does help restore the state's fiscal health during economic downturns. These protected monetary reserves help mitigate the need to cut spending or raise taxes to fix short-term problems during an economic downturn.

The Budget Reserve Fund currently contains no balance to cover any of the FY 03 deficit. The fund balance was completely drawn to partially cover the \$817.1 million deficit in FY 02. Given the current fiscal conditions, it may take a number of years before the state may attain the 10 percent level. **The program review committee recommends the 10 percent level be maintained until better information is available on what level is most appropriate.**

Every effort should be made to guarantee that a certain level of funding be deposited in the rainy day account. However, the state should retain some flexibility in the use of surplus dollars. In addition to building a rainy day cushion, the state may want to balance the benefits of using surplus funds for additional debt reduction or avoidance. A recent OFA analysis showed a total saving in interest payments over 20 years to be \$63 million per \$100 million of surplus used to retire debt.<sup>17</sup> The flexibility allows the legislature to consider what is in the state's best interest.

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## GAAP Accounting

State financial information is reported in two ways. Connecticut uses a modified cash accounting system for its budgeting purposes. The Generally Accepted Accounting Principles system prescribed by the Government Accounting Standards Board is used by the comptroller for

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<sup>17</sup> *OFA Projections*, December 18, 2000

fiscal reporting, including the state's official year-end statement, the Comprehensive Annual Financial Report (CARF).

GAAP accounting, a widely recognized best practice, contributes to accurate, understandable budget information by imposing strict standards for the posting of revenues and expenditures. In contrast, modified cash accounting over counts certain tax income and undercounts some expenditures within a given fiscal year.

Conversion to the GAAP accounting system was mandated by the legislature in 1993. The implementation date has been postponed repeatedly, however, and now is set for FY 06. The system has not been adopted for budgeting purposes largely because of high implementation costs.

According to OFA, converting to GAAP budgeting will require about a \$33 million increase to the annual General Fund appropriation in FY 06 in order to recognize actual spending and revenue earned within the fiscal year. The higher accumulated deficit recognized under GAAP accounting also would have to be addressed to fully convert to the new system. OFA estimates also amortizing the GAAP deficit could annualize to a total cost of more than \$96 million over the following 15-year period.

Projections by the Office of Fiscal Analysis indicate the budget will be closely balanced in the current biennium, and a substantial deficit is possible in FY 06. Given this outlook, the committee believes there will be little support for applying scarce resources to what is perceived as essentially an accounting change despite its broader benefits of improved understandability and accuracy. Delaying implementation until the economy improves may be both financially and politically necessary.

Based on committee staff interviews with representatives of the major bond rating agencies, it appears adopting GAAP, while desirable, is not critical to favorable state bond ratings at this time. However, as more states switch to the system and it becomes the predominant model, GAAP accounting will be a more important rating factor.

GAAP accounting, like maintaining a healthy rainy day fund and applying unanticipated surpluses to debt retirement, is an important component of sound financial management. The opportunity to convert to GAAP accounting while the state was experiencing unprecedented revenue growth and consecutive years of large budget surpluses was missed. **The program review committee recommends funding conversion to the GAAP system be made a priority for the use of any future state surpluses.**

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## Spending Cap Impact

Connecticut's statutory spending cap, in place since 1991, was intended to ensure annual growth in state spending does not surpass the growth of the state's economy. *The program review committee found the spending cap has been effective in constraining the growth of the state budget.* Figure 7 shows OFA data on the state's budget growth rates since FY 87. Both nominal and inflation adjusted rates during the late 80s and early 90s were very high, at times reaching double digits. However, expenditure growth rates since the introduction of the spending cap have been on an overall downward trend.

The spending cap has allowed the state to curb budget growth. With the exception of the expenditure of surplus funds reflected in FY 01, implementation of the spending cap significantly helped hold down growth during the last 10 years. It may be argued that the challenges of the current fiscal crisis would be far worse if not for the constraints of the spending cap. According to OPM projections, the state's fiscal problems in FY 03 would have been at least twice as bad without the spending cap.<sup>18</sup>

There is some debate as to whether Connecticut's spending cap is too restrictive resulting in unintended consequences. The program review committee agrees *Connecticut's spending cap is strict particularly when compared to other states.*

Connecticut includes most of its federal funds in its cap calculation, while many states exclude them. Connecticut's spending cap applies to a high proportion of state expenditures. The caps in other states typically apply only to their state general fund, while all 10 state appropriated funds in Connecticut are subject to the cap. A three-year average of personal income growth is common in other states that use them in their cap calculations. Connecticut uses a five-year average.

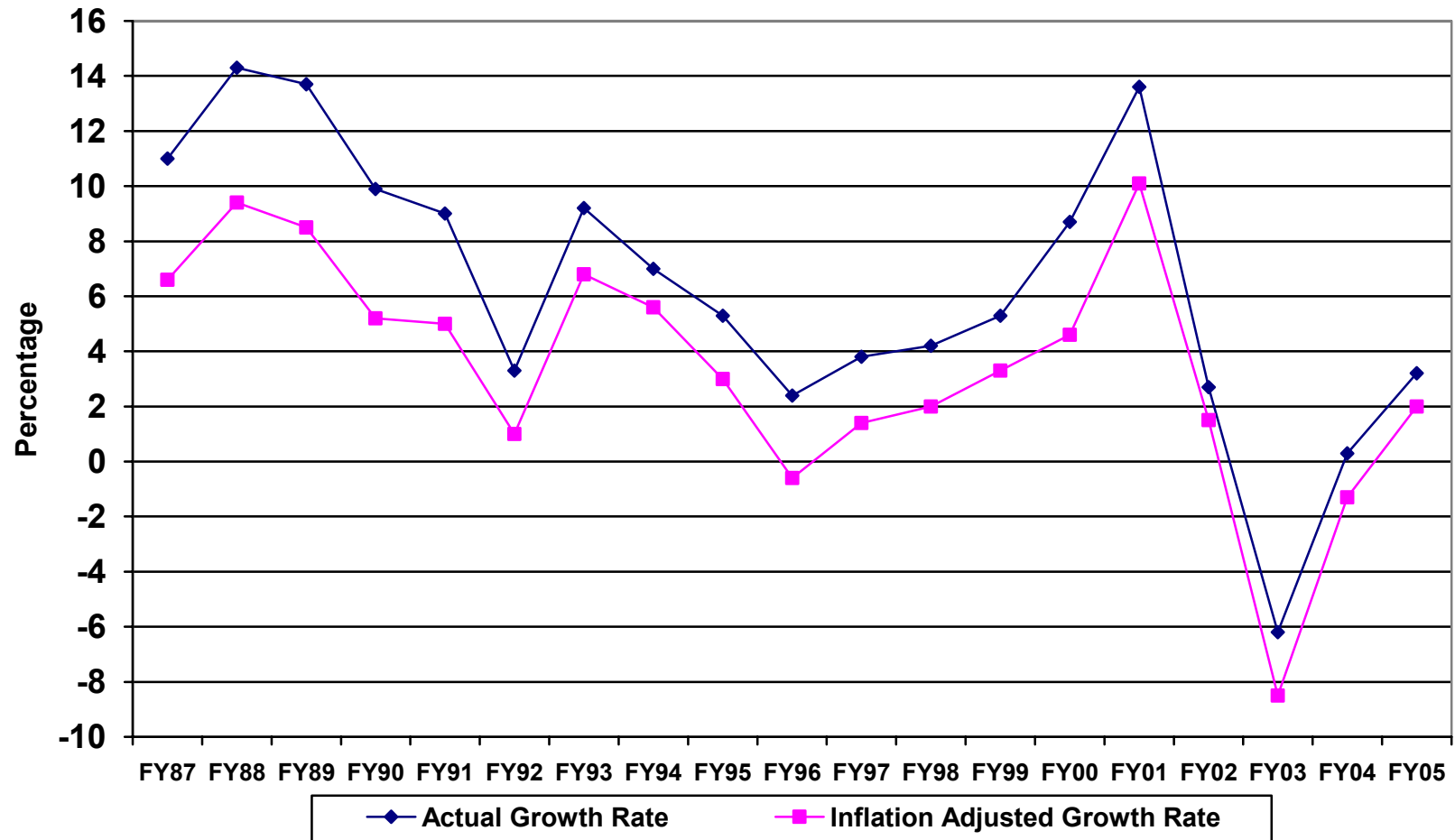
In addition, a decision to exceed the Connecticut cap requires consensus and a super majority vote of both the governor and a 3/5th legislative approval. While strict, the declaration of extraordinary circumstances allows decision makers some flexibility. It is the most straightforward way to decide to exceed the limit on spending.

The spending cap was exceeded four times since it was adopted in 1991. The last time was in FY 01. At that time, the governor issued a declaration of extraordinary circumstances as permitted by law. Those circumstances included consecutive years of budget surpluses, sufficient funds to

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<sup>18</sup> Governor's Budget Summary FY 03-05, page 6.

**Figure 7. General Budget Expenditure Growth**



completely fill the rainy day fund, and the requirement for additional state funds for other needs.

At the governor's discretion, the declaration may provide that the expenditures above the cap not be considered for the purposes of determining the subsequent year spending cap base. To date, the governor's declarations have explicitly excluded surplus funds from the base for the purposes of calculating the allowable spending increase.

The exclusion of surplus spending means future years' spending limits will not increase based on additional expenditures in an earlier year. Conversely, if surplus expenditures are not explicitly excluded, they will be reflected as part of the base increasing the cap in the following year.

Critics of the cap's strict structure claim it: 1) gives rise to budgeting techniques to circumvent it; 2) contributes to an increase in state bonding; and 3) limits the state's access to federal funds. Program review committee analysis of each of these criticisms is summarized below.

**Budget techniques.** Whether certain proposed expenditures are subject to the spending cap depends on how funds are categorized during the budgeting process. At various times, both the legislature and the governor have used the following techniques to exclude certain funds from mandated spending restrictions.

Statutory declaration. The legislature may adopt a statutory declaration that certain expenditures are to be deemed appropriated for purposes of the spending cap calculation. The legislature has done this on at least one occasion.

Recently, the federal Workforce Investment Act (WIA) required states to approve job-training funds as part of the reorganization of the former Job Training Partnership Act. Those funds had previously been sent directly to the regional workforce development boards without legislative approval. The state legislature passed Public Act 00-192 redefining the spending cap base. The statutory language deemed those funds to have been appropriated even though technically they had not. The funds then became part of the budget base for spending cap calculations.

Use of lapses and carry-forwards. The spending cap only limits how much the General Assembly and the governor can appropriate each year. There are several budgeting techniques that allow funds to be spent without ever being appropriated for purposes of the cap. The use of lapses and carry forwards fall outside the spending cap after appropriations have been made.

Lapses occur when a state agency does not actually spend all of the money appropriated to it. Lapses can be applied to cover deficiencies in other

areas. This technique of using lapses to cover shortfalls results in spending that does not have to be appropriated and, therefore, is not counted toward the spending cap.

Similarly, if an agency does not spend its total appropriated funding within a fiscal year, the funds may be held over or carried forward until the next budget year. If funds are carried over from one year to the next, they only count against the spending cap limit in the year that they were originally budgeted.

*Tax expenditures.* Another problem attributed to the spending cap is that it encourages the use of tax expenditures as a form of “unappropriated” spending. Tax expenditures are usually seen in the form of tax credits, exemptions, exclusions, deductions, or rate reductions. Tax expenditures are sometimes viewed as spending because they in fact carry a “cost” to the state in the loss of potential revenue and many times are intended to accomplish some public policy purpose. Tax expenditures are not line items in the state’s operating budget and are not subject to the spending cap.

Unlike a direct appropriation, a tax expenditure does not need to be re-enacted each budget period. It continues indefinitely until amended, repealed, or a sunset date is placed upon it. Therefore, a tax expenditure is typically not revisited or reviewed after passage.

In theory, the program review committee agrees tax expenditures may induce a form of “back door” spending. In FY 02, OFA estimated major identifiable state tax expenditures totaled close to \$4 billion.<sup>19</sup> Due to the format of available information and time constraints, the committee was not able to determine whether there is a growing reliance on tax expenditures. Interviews with various legislators suggest more scrutiny is warranted in this area.

State law currently requires OFA to prepare a tax expenditure report every two years (C.G.S. § 12-7b(e)). The report includes a description of each tax expenditure, the year it was enacted, its purpose, an estimate of revenue loss, and the number of taxpayers benefiting. The report does not evaluate the expenditures, make conclusions or recommendations regarding whether a provision should be continued, repealed, expanded, or restricted. The report is made available to all legislators. State law requires the finance committee to meet and analyze the report. It does not appear that this has ever occurred.

The program review committee believes Connecticut’s tax expenditures should be analyzed periodically to ensure they still make fiscal sense with

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<sup>19</sup> OFA, *Connecticut Tax Expenditure Report*, January 2002

the changing economy or policy priorities, or continue to be in the state's best interests. The analysis would promote greater transparency and accountability in the enactment and continuation of tax expenditures as well as the development and adoption of the state budget.

*Earmarking funds.* Similar to the criticism of tax expenditures, intercepting revenue or “earmarking” funds from a particular source for a specific purpose may also be viewed as a way to spend without appropriating funds. Earmarking to fund specific programs eliminates the need to annually appropriate funds to them. Thus, earmarked funds are not subject to the spending cap.

Information regarding earmarked funds is not readily accessible. OFA analysis estimates approximately \$141.5 million in General Fund taxes were earmarked in FY 04 for a variety of purposes. Additional analysis would be necessary to accurately identify the amount of all earmarked revenue. There is no evidence that earmarking is a significantly increasing practice. As with tax expenditures, it is not clear whether earmarking has been used to bypass the spending cap. More extensive monitoring of earmarked funds is needed to identify their impact on spending cap compliance.

**Bonding operating expenses.** Another criticism of the spending cap is that it contributes to the growth of state indebtedness. Some believe the state has increasingly turned to bonding as a funding mechanism for on-going operating expenses. Table 15 shows the portion of new state bonding allocated for on-going programs each year over a recent three-year period.

**Table 15. New Debt: Total Amounts Bonded: FY 99 – FY 01**

<b>Fiscal Year</b>	<b>Total New Debt</b>	<b>Infrastructure/ Long-Term</b>	<b>On-going Expenses</b>
	\$		
99	\$1,008 million	45% (\$454)	55% (\$554)
00	\$1,126 million	43% (\$489)	57% (\$637)
01	\$1,327 million	61% (\$816)	39% (\$511)

Source of Data: The Comptroller's Report: Connecticut's Economic Health, 1999 -2002

The state issued \$1.3 billion in new debt in FY 01. Most of this amount, (\$816 million) was applied to infrastructure projects or other assets with long-term benefits; however, 39 percent (\$511 million) funded on-going state expenses. The percentage of debt used for operating costs was even higher in FY 00 (57 percent) and in FY 99 (55 percent).

The comptroller's analysis indicates a practice of issuing a significant portion of bond funds for purposes other than one-time, long-term investments. As the comptroller states in each report, bonding for on-going programs that should be considered part of normal government operating expenses is not sound fiscal policy.

The program review committee agrees this constitutes an unfavorable practice but there is no indication it is primarily due to the spending cap structure. Significant declines in revenue and perhaps an unwillingness to make difficult decisions regarding spending cuts or tax increases play more of a role. It is clear whatever the cause, the state should avoid prolonged use of this bonding approach or it may jeopardize Connecticut's favorable bond rating.

**Access to federal funds.** Connecticut receives federal funds for a broad range of services. These funds come into the state in a variety of ways. Some federal funds, such as competitive grants, go directly to a state or local entity for a designated purpose. There are also federal block grants, such as the Social Services Block Grant, which the state legislature allocates. These types of federal funds are not "appropriated" by the state legislature and are not subject to the spending cap because they are not considered "general budget expenditures" as defined by statute.

Federal funds requiring a matching state expenditure to be eligible for federal reimbursement, such as Medicaid, are counted as "general budget expenditures." These funds have historically been "gross budgeted", meaning the full amount of funding for these programs is appropriated by the legislature, and then claims are submitted to the federal government quarterly to obtain reimbursement. Any federal funds received as reimbursement are deposited into the General Fund as revenue.

It is argued that the restrictive structure of Connecticut's spending cap deters efforts to seek and obtain new federal funds. Committee staff asked OFA and OPM staff and representatives of a number of advocacy groups for an actual example of when the state did not maximize federal funds because of the spending cap. Two examples given were the Medicaid Adult Rehabilitation Option and the Disproportionate Share (DSH) program that reimburses hospitals for a portion of the uncompensated care they provide.

The DSH example was the clearest case of a federal maximization issue. During 2001, the legislature lowered the disproportionate share payments to hospitals by \$100 million to make \$100 million available under the cap. The legislature restructured the state's hospital disproportionate share program substituting some tax relief rather than direct payments. The change scaled back federal reimbursement for the state by \$50 million and removed the tax relief amount from the spending cap.

The program review committee agrees this serves as an example of where the state did not maximize federal funds. However, the committee believes the main reason was not the spending cap structure but rather a policy decision about hospital funding approved by the legislature.

Building upon prior OFA analysis, the program review committee examined the impact of excluding federal funds from the spending cap. The committee compared the current cap calculation with one based upon federal exemption using only federal funds that are currently subject to the spending cap. The results are presented in Table 16.

**Table 16. Spending Cap and Federal Funds (Dollars in Millions)**

	FY99	FY00	FY01	FY02	FY03	FY04	FY05
<b><u>HISTORICAL SPENDING CAP CALCULATION</u></b>							
Capped Expenditures	8,404.5	8,821.2	9,294.4	9,744.0	10,210.5	13,217.8	13,520.5
Growth Factor (Personal Income)	4.86 %	5.08 %	5.48 %	5.33 %	6.20 %	5.30 %	4.50 %
Allowable Growth	408.4	448.1	509.3	519.3	633.0	700.5	608.4
<b><u>FEDERAL REVENUE &amp; SPENDING CAP GROWTH FACTOR</u></b>							
All Federal Revenue	1,923.7	1,989.5	2,035.4	2,142.3	2,315.8	2,527.0	2,382.0
Actual Federal Revenue Growth (year to year)	40.1	65.8	45.9	106.9	173.5	211.1	(145.0)
Actual Percentage Growth	2.13 %	3.42 %	2.31 %	5.25 %	8.10 %	9.12 %	(5.74%)
<b><u>CALCULATION EXEMPTING FEDERAL REVENUE</u></b>							
Capped Expenditures minus Fed. Revenue	6,480.8	6,831.7	7,180.7	7,601.7	7,894.6	10,690.8	11,138.5
Growth Factor (Personal Income)	4.86 %	5.08 %	5.48 %	5.33 %	6.20 %	5.30 %	4.50 %
Allowable Growth	314.9	347.0	393.5	405.1	489.4	566.6	501.2
<b><u>COMPARISON</u></b>							
<b>Difference *</b>	53.3	35.2	69.9	7.2	(30.0)	(77.1)	252.1

\* This figure is the difference between current capped expenditures compared to capped expenditures minus federal revenue and federal growth.

Source: LPR&IC Analysis

As the table shows, federal revenue during FYs 99-02 actually grew at a rate less than the spending cap growth factor (the five-year average of personal income). When this occurs, more allowable spending growth is permitted when federal funds are included in the spending cap calculation.

However, the reverse is true when the federal revenue growth exceeds the allowable spending cap growth, as anticipated in FYs 03-04; then, less room is available under the cap. In other words, exempting federal funds may at times result in a further constraint on appropriated expenditures and at other times it may allow additional growth to occur that would not have otherwise been available had federal funds been excluded from the base of the budget.

Furthermore, if federal funds are removed from calculations of the cap, the result would be a much smaller base upon which to calculate the succeeding year's budget. This would cause the level of expenditures to shrink in future years.

Over the years, various proposals have been made to change the spending cap. In addition to exempting all federal funds, there have been to proposals to:

- exclude new federal funds for the first year;
- exclude certain fast growing programs such as Medicaid;
- eliminate the exemption of aid to distressed municipalities;
- shorten the average number of years used to calculate growth factor; and
- use adjusted gross income or a capital gains factor to calculate the base.

The program review committee was unable to thoroughly examine the complexities and potential impact of these proposals within the study time constraints. However, the committee's limited review of some proposals suggests no cap configuration will produce a perfect mechanism.

The extent to which the current spending cap structure may be viewed as restrictive depends on how fiscally conservative the viewpoint is and what the policy goals are. This is also true for any other reconfiguration of the cap. The implications of modifying the spending cap may involve significant policy shifts. For these reasons, the program review committee does not recommend changing the current statutory definitions without further study of all consequences.

However, the committee finds *the problem of federal maximization is not necessarily based on the spending cap structure but rather the decisions made*. Even in good economic times, the maximization of federal funds is predicated more on the decisions of policymakers than availability under the spending cap. Making more room under the cap simply allows the state to make additional spending decisions.



As discussed earlier, most federally reimbursed programs require a state funding match. The argument that the spending cap has deprived the state of the opportunity to obtain federal dollars assumes that the state will have revenue resources and the commitment to sustain the required match. If sufficient revenues do not exist, then the opportunity may not be one the state can afford.

The committee believes *the existing statute already allows the state discretion in exceeding the cap*. The statute contains provisions for the spending cap to be exceeded when circumstances require it. Therefore, the state, when consensus exists, may pursue federal options even if the spending cap would be prohibitive. In the opinion of the program review committee, the state should be examining ways to further maximize federal funds, as discussed in the next section.

**Conclusion** Connecticut's spending cap has a considerable impact on the state's budget making process. It serves an important function ensuring budgetary growth does not exceed the growth of the state's economy. The spending cap has indeed helped control state spending. Without it, the extent of the state's fiscal woes may have been exacerbated.

Nonetheless, the spending cap is not a perfect mechanism. The variety of ways to circumvent the cap suggests that it is, in some sense, an artificial constraint. The program review committee believes the unintended consequences typically associated with the spending cap structure are more likely attributable to decision making. In addition, the state's reduced revenues may be causing a more severe restriction on the ability to make spending decisions than the spending cap.

The current spending cap structure does provide the state considerable flexibility when necessary. However, there should be concern that flexibility via budgeting techniques may lead to abuse or misuse. As such, the committee finds that modifications to the spending cap warrant further review of both technical and policy implications.

Given Connecticut's current economy and decline in revenues, the spending cap is unlikely to become a factor in near future. This presents the state with the opportunity to fully consider possible modifications before the cap comes into play again.

A multi-year legislative initiative established in 2003 to study state government efficiencies and accountability, Operation ACE, is contemplating various issues including fiscal reforms for further examination. The program review committee believes this effort provides a timely opportunity to revisit the spending cap, particularly in light of the group's other interests which include maximization of federal funds.

## Maximizing Federal Funds

Federal revenue is a significant funding source for a broad range of state programs. Efforts to maximize federal funds provide the state with the ability to strengthen and expand important services. Federal funds account for approximately 18 percent of state expenditures in Connecticut.

Connecticut's high per capita personal income and low statewide poverty rate make it a relatively wealthy state. This influences the amount of federal assistance Connecticut receives as federal funds are typically allocated based on need. A recent report published by the Federal Funds Information for State (FFIS) ranks Connecticut against other states based on the receipt of various types of federal aid.<sup>20</sup> According to FFIS, Connecticut ranked:

- 47<sup>th</sup> in federal grants to state and local government per dollar of taxes;
- 24<sup>th</sup> in direct payments such as social security and Medicare;
- 17<sup>th</sup> in Medicaid spending; and
- 15<sup>th</sup> in total federal spending on per capita basis in FFY 01.

Maximizing federal funds requires a concerted effort by both the executive and legislative branches. All federal funds are predicated upon federal law and regulation. States must maintain certain standards and meet specific requirements to receive federal reimbursement. Often the executive branch must obtain the legislature's authorization to establish a program eligible for federal funds and receive a legislative appropriation to sustain or expand the program.

OPM has acknowledged more needs to be done to maximize federal revenue. Currently, each individual state department or agency must independently pursue federal funds. Several state agencies do not have the staff resources or expertise to perform this function while others do not appear to have the initiative.

Over the years, several efforts have been made to increase the state's share of federal funds. In the early to mid 90s, Connecticut established a task force on federal fund maximization as well as a federal fund advisory council. Both bodies produced reports outlining a variety of ways to increase federal funds. However, Connecticut's need for additional resources was lower during the years of budget surplus.

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<sup>20</sup> FFIS is a service provided to the National Governors Association and National Conference of State Legislatures to track and report on the fiscal impact of federal funding to the states.

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Recently, both the executive and legislative branches have considered several state agency initiatives. However, it is difficult to determine if the state is pursuing all federal revenue opportunities. Connecticut makes little to no attempt to determine what opportunities it is eligible for, applied for, or did not receive. There is no centralized collection of this data. In the early 1990s, OPM considered creating a central clearinghouse, but, it was never implemented due to budget cuts.

As mentioned earlier, legislation intended to promote maximization of federal funding was adopted but vetoed during the 2003 session (P.A. 03-157). The act would have required OPM, in consultation with OFA, to develop a plan to increase the level of available federal funds and each state agency to annually assess and report on the amount of actual and potential federal funds it may receive. The report, which was to be submitted to OPM, OFA, and the legislature's Appropriation Committee, was to include an assessment and explanation of federal funds available but not accessed by the agency.

The governor vetoed this public act indicating it unnecessarily used state resources to accomplish a task already performed. The governor also stated the act did not give the legislature any more information than it currently receives or could gather through the existing process.

Given the state's current economic condition, Connecticut needs to become more aggressive in exploring federal funding options. The committee believes there should be a single point where decisions regarding maximizing federal revenue are reviewed and coordinated. As the state's lead planning and policy agency, OPM is the logical choice.

**Therefore, the program review committee recommends the Office of Policy and Management be designated the single point of contact for federal revenue maximization. Within available resources, OPM may seek outside contractors to identify maximization opportunities.**

The program review committee recognizes this is an additional responsibility for already limited OPM staff resources. However, the committee believes decisions on the commitment of future state funding should be consolidated within the executive budget and planning agency.

When necessary, OPM should seek outside expertise to find ways to capture additional federal funds. The state may also stipulate the outside contractors receive a percentage of the new revenue they generate. Connecticut has already contracted with a private consultant, Maximus, to perform this function in the Department of Social Services. (The issue of federal fund maximization specifically related to social services is

discussed in a concurrent program review report, *Consolidation of Rehabilitative Services, 2003*.)

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## Budget Cycle

One of the main reasons the state returned to biennial budgeting in 1993 was to promote performance review and program evaluation. The process was intended to focus on making major programmatic and budget policy decisions in the first year of the biennium; fiscal considerations in the second year would be limited to technical revisions, minor adjustments, and emergencies. The second year, which coincides with the shorter legislative session, would also be the “off budget” year devoted to in-depth evaluation of agency programs.

This is not what occurs in practice. Beginning with the first biennium, the governor and the legislature have proposed new and expanded programs along with significant policy changes in each year of the cycle. As a result, second-year adjustments and revisions to the budget are often extensive. There is also no evidence legislators or state agencies give greater attention to program outcomes and performance measures in the second year of the cycle.

Some have suggested returning to an annual budget with a requirement for out-year projections, claiming it would be a simpler process with little practical difference from the state’s current biennial approach. As noted in the committee briefing report, current research shows no clear advantage to either budget cycle. However, for the following reasons, **the program review committee recommends the biennial budget cycle be retained.**

*First, biennial budgeting is generally more conducive to the long-term planning perspective experts recommend.* Connecticut’s biennial budget process requires allocation decisions be made for two years and projections for three out-years be considered. An annual budget could include multi-year projections, but such estimates are usually reviewed less rigorously than actual spending levels.

*Second, biennial budgeting can also ensure the full funding implications of programs initiated mid-year will be documented.* Similarly, intentional under-budgeting of a program in one year and making up the shortfall with deficiency spending or transfers in the following year can be discouraged.

*Finally, a biennial process provides greater opportunity for performance evaluation activities.* To date, legislators have not chosen to adhere to the budgeting agenda envisioned under the 1991 budget reforms. However, it

remains possible to reserve the second year primarily for developing performance measures and examining program results.

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## Setting Budget Priorities

To make informed budget choices, decision makers first need good data on expenditures, revenues, and results. To optimize spending decisions, legislators also need an effective way to identify and focus on priorities. *The program review committee found revisions to the existing budget preparation process are needed to improve the type of information available to legislators and the manner of setting spending priorities.*

**Information needs.** Legislators receive a substantial amount of information related to state expenditures and revenues. In addition to the governor's numerous budget documents and a wide variety of OFA publications, financial reports prepared by the comptroller and the Department of Revenue Services department are available to members of the General Assembly on a monthly and annual basis.

*While there is an almost overwhelming supply of data on what is spent and what comes in, information about the results of state spending decisions is generally missing from Connecticut's budget process.* The best budgeting practices incorporate a focus on results and outcomes that comes from an effective performance measurement system. Recommendations developed by the program review committee to address the lack of performance information for budgeting purposes are discussed in detail in a later section of this report on performance measurement.

Another problem is related to the fact most of the budget preparation process within OPM and the legislature is concerned with details about spending for specific programs and line items. The bulk of the information and discussion about the budget centers on short-term decisions for particular agency accounts. There are few opportunities for legislators other than the leaders and the heads of the fiscal committees to put all the pieces that contribute to a balanced budget into a larger context.

The program review committee believes *better decision making is possible if all legislators have a greater understanding of the interrelationships and long term impact of spending decisions.* In addition, being familiar with the "big picture" of the state's financial condition can help legislators set priorities for the use of scarce resources during economic downturns as well as surpluses when times are good.

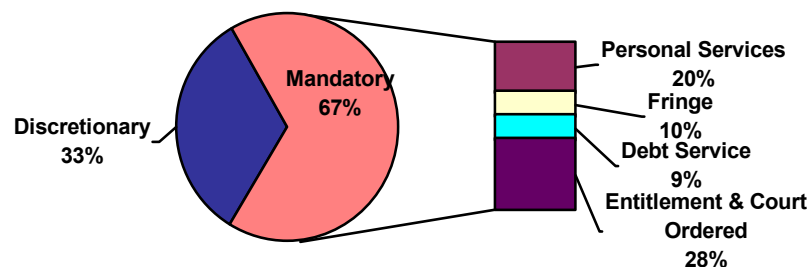
At present, factors critical to the budget process, such as the implications of spending cap provisions or the assumptions behind revenue estimates, are not widely known or understood. Available data on long-term trends,

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such as OFA's detailed General and Transportation Fund budget projections, are infrequently used to guide committee work on proposed agency budgets.

In other cases, information useful to legislative deliberations on spending has not been developed. For example, in response to questions from committee members, program review staff requested OFA to identify funding areas in the budget that are "mandatory," meaning constrained by court orders, federal requirements, or collective bargaining agreements (assuming current resource levels), versus more discretionary spending areas. The analysis, which is summarized in Figure 8, is an example of the type of overview information that should be available in order to set priorities.

**Figure 8. FY 04 Net General Fund: Analysis of Mandatory\* & Discretionary Expenditures**



*\* This amount of mandatory spending reflects a definition that assumes current levels of personnel and a strict interpretation of entitlements and court-ordered programs; different assumptions would lead to higher or lower proportions.*

Source of data: OFA

Under current law, the appropriations committee is required to hold a public hearing each year on or before November 15 concerning potential deficiencies in agency appropriations. The hearing has become a forum for committee members to discuss broader spending and revenue trends as well as specific deficiency areas with OPM and OFA staff.

Most recently, the Office of Fiscal Analysis presented a fiscal forecast to appropriations committee members during the deficiency hearing. In the presentation, OFA staff: outlined the state's deficit history; identified potential deficiencies and new needs for added funding; detailed spending

projections for major state programs; and described the multi-year budget implications of spending cap restrictions and one-time revenue sources.

The program review committee believes OFA's fiscal forecast approach to the November hearing should be continued and expanded. It offers a much needed opportunity to present a macro view of the state budget situation and alert decision makers to upcoming fiscal issues.

**It is recommended C.G.S. Section 2-36a be amended to require a joint informational meeting be held by the appropriations and finance committees each year by November 15 to consider the current and future balance of the state general budget. At a minimum, the Office of Fiscal Analysis should be requested to provide information on:**

- trends in expenditures and revenues;
- potential deficiencies and new spending requirements;
- assumptions for revenue forecasting;
- tax expenditures;
- federal funding;
- mandatory versus discretionary funding;
- spending cap calculation and considerations; and
- possible uses for surplus funds, including but not limited to the budget reserve fund, debt retirement, and funding of pension liabilities.

**The Office of Policy and Management, the comptroller, and treasurer should also be requested to provide information and participate in the informational meeting.**

An open meeting devoted to the major factors affecting the state budget will also contribute to making the process more understandable to the public as well as decision makers. In addition, the recommended joint meeting is a formal way to link spending and revenue considerations earlier in the process.

One document that contributes greatly to the transparency of the budget process is an Office of Fiscal Analysis publication called the "budget book." *The OFA budget book is the most comprehensive source of information regarding adopted state budgets.* It includes information on all appropriations, bond authorizations, and tax and revenue changes. It also explains legislative intent concerning appropriated funds and summarizes significant changes made to agencies under newly adopted legislation.

*There would be a serious loss to the understanding of the state's spending plan if it was not prepared. Therefore, the program review committee recommends the budget book prepared each year by the Office of Fiscal Analysis be required by law and be made available to the public within 60 days of final action on the current year's fiscal legislation.*

**The OFA budget book should continue to contain: an overview of the appropriations, tax and revenue changes, financial schedules, agency budgets, the capital budget, and the final appropriations act. In addition, a concise summary and guide to key budget issues should be prepared for use by the general public and included in the book.**

There is no indication the fiscal analysis office would not produce the annual budget book. However, it is not a mandated responsibility like the office's biennial report on tax expenditures or the end-of-session compilation of fiscal notes. Making the budget book a statutory requirement ensures its continued production and availability to all legislators and the public.

A concise summary for the public is a recommendation of the Government Finance Officers Association intended to promote involvement as well as education. In keeping with GFOA criteria, the summary should:

- summarize major changes in priorities and the factors leading to those changes;
- articulate priorities and key issues for the new budget period;
- identify and summarize major financial factors and trends affecting the budget;
- provide financial summary data on revenues, other resources, and expenditures for a multi-year period; and
- define a balanced budget, state if the budget is balanced or not, and if not, explain why.

**Formal process.** Decisions during Connecticut's budget preparation process center on current services and whether to make incremental increases or decreases in specific areas. Spending and revenue matters are generally analyzed by separate committees. As noted earlier, the official revenue estimate of the finance committee is not adopted until after the state's spending package is proposed by the appropriations committee.

While specialization and a focus on detail are necessary for a thorough consideration of complex budget issues, this approach has major shortcomings. *It does not foster a long term perspective or focus on priorities, the key characteristics of good budget decisions.*



Informal discussions about budget goals usually occur among the leadership of both chambers and the fiscal committees throughout the budget process. In contrast, several other states reviewed by the program review committee have formal mechanisms for setting spending priorities at the beginning of the legislative session. Procedures followed in Utah and Maryland are summarized below.

<u><b>Utah Budget Allocation Process</b></u>	<u><b>Maryland Spending Affordability Process</b></u>
<p>An executive appropriations committee comprised primarily of leaders from both chambers and parties meets during the week before the session begins to adopt a revenue estimate and make allocations to the 10 joint budget subcommittees.</p> <p>The subcommittees make spending decisions within their allocations (which may be revised by the executive committee during the session, if conditions warrant changes) and report them to the executive committee near the end of the session.</p> <p>If subcommittee overspends its allocations, the executive committee will direct it to reconsider its decision to come within the budget. If necessary, the executive committee may overrule subcommittee decisions to achieve a balanced budget.</p>	<p>A statutorily established spending affordability process is carried out by a joint committee of legislative and fiscal committee leaders from both parties plus representatives of the public.</p> <p>The spending affordability committee's main purpose is to limit the rate of growth of state spending to a level that does not exceed the growth rate of the state's economy. The committee meets annually in the late fall to consider revenue and expenditure projections.</p> <p>By December 1 each year, the committee submits a report to the legislature and governor with recommendations on fiscal goals for the state budget including: recommended levels of spending, new debt, and state personnel; proposals for the use of any unanticipated surplus; and other findings and recommendations the committee considers appropriate.</p>

The program review committee believes setting budget priorities through a formal process similar to the ones followed in Utah and Maryland would contribute to better spending decisions in Connecticut. **It is recommended a special budget committee consisting of the majority and minority leadership of both chambers and the leadership of the appropriations and finance committees be established and meet at least one week before the start of the regular session to: set spending targets for each major policy area based on current and prospective economic conditions; and adopt an estimate of revenue available under the existing tax structure and under any proposed modifications.**

Under this recommendation, a legislative agenda for spending would be developed early in the process and in light of projected revenues. Targets

set by the special committee would be guidelines for decision making within the appropriations subcommittees and the substantive committees. Revisions and negotiations would still occur, but the framework for discussion would be openly established. The enhanced joint informational meeting recommended above could serve as a starting point for developing that framework.

Representative of the bond rating agencies interviewed by program review committee staff described the most highly rated states, like Maryland and Utah, as the ones that: have a long-term perspective; demonstrate they are thinking ahead; consider options and different scenarios; and can set priorities and stick to their plans. The committee proposal for a budget priority committee is intended to promote those types of activities within Connecticut's process.

## Timely Resolution

Currently, Connecticut's constitution and statutes do not reference a timeframe for when the state budget must be enacted. Traditionally, the final budget is considered and voted by both chambers very near the end of the regular session. In some years legislators had to return in special session because there was not enough time to finish the budget before the constitutional session end date.

The general political expectation is that a balanced budget will be enacted before the beginning of the fiscal year. On two occasions since 1990, the budget has been adopted after the start of the new fiscal year. As the information presented in Table 17 indicates, *the time it takes the legislature to adopt the state's biennial budget is increasing.*

**Table 17. Enactment History of Connecticut's Biennial Budget**

Year	First Day of Regular Session	Last Day of Regular Session	Date Legislature Adopts Budget	Length of Time From Session End
1993	1/6/93	6/9/93	5/11/93	29 days before
1995	1/4/95	6/7/95	5/31/95	7 days before
1997	1/8/97	6/4/97	6/3/97	1 day before
1999	1/6/99	6/9/99	6/4/99	5 days before
2001	1/3/01	6/6/01	6/26/01	20 days after
2003	1/8/03	6/4/03	7/31/03	57 days after

Source: LPR&IC Analysis

In 1993, the legislature approved the budget almost a month before the end of the session. The next biennial budget was adopted a week before the session ended. In the following biennium cycle, the budget was approved with a day left in the regular session. Since 2001, the state budget has been enacted during special session. In 2003, the state was a month into the new fiscal year before the final budget was adopted.

According to the National Conference of State Legislatures, many states had difficulty adopting their budgets this year. Late budgets and vetoes seem more likely when a state is experiencing financial problems or there is a divided government structure. A review of the enactment practices in other states revealed some interesting provisions and procedures if the budget is not passed by the beginning of the fiscal year.

In Maryland, the state constitution requires the budget be enacted by the 83<sup>rd</sup> day of the 90-day legislative session. If the budget is not enacted by midnight of the 83<sup>rd</sup> day, all other pending legislation dies and only the budget can be considered. To date, Maryland has adopted its budget within the constitutional provisions although passage came closer to the deadline this year. Interestingly, Maryland also has a divided government.

The timely resolution of Connecticut's budget should be of concern. There are several negative effects of adopting a budget after the regular session. Late passage of the budget incurs the costs of conducting special sessions, has a corresponding delay in the passage of any budget implementers, projects a poor public image, and is indicative of a breakdown of the committee process.

*In addition, there are at least three potential concerns, if the state does not have a budget in place by the start of the fiscal year. First, bond agencies may lower the state's credit rating. Program review committee staff discussions with bond agencies indicate this is a pattern they monitor when evaluating a state. Second, there is a ripple effect on municipal budgets. Until the state budget is adopted, municipal budgets remain unstable awaiting final determinations for municipal aid. Third, if the state enters the new fiscal year without a budget, another procedural challenge arises – how to finance state operations until the budget is resolved.*

**Therefore, program review committee recommends the General Assembly institute a provision requiring the budget be enacted a week before the end of the regular session. If this does not occur, all pending legislation shall die and only the budget may be considered.**

There is some evidence that Connecticut follows this practice informally with leadership controlling the flow of fiscal bills. However, a formal provision would encourage committees to complete their work earlier and create a disincentive to use tactics that delay legislative decisions. Arguably, the legislature may adopt a budget within the regular session timeframe only to have the governor veto it. Such a provision may

intensify negotiations and further complicate the implementer process with more negotiable items.

Despite these drawbacks, the committee believes *there is a greater advantage in starting budget deliberations earlier in the process, even if the proposal ultimately fails*. Crafting a legislative budget involves addressing some of the state's most complicated and controversial issues. Given the number and variety of interests and issues to be reconciled for a budget to be completed, the process is bound to encounter roadblocks and delays. This is particularly evident during times of fiscal difficulties. A deadline does not guarantee timely resolution but it may keep decisions from becoming too compromised by truncating the time available for consideration.

**Implementer process.** In addition to the primary budget bill, the legislature enacts implementer bills that provide greater detail on how budgeted funds are to be spent. As mentioned earlier, *there is not an identifiable process for the development of the implementers*. They are not specifically addressed in state law or legislative rules.

The implementer process was a frequently cited source of frustration during program review interviews. It is commonly acknowledged that implementer bills are often vehicles for indirectly making policy changes. Another common complaint was that many times legislators were asked to vote on implementers without a full understanding of what is included in the bills. A perception seems to exist that the implementer process is subject to the “back room phenomena” – where only a few people decide what the bill contains.

Individuals who participate in the implementer process disagree that only a handful of people are involved. They reported there are approximately 20-30 people including legislative leaders, fiscal chairs, subcommittee chairs, legislative and agency staff involved in the development of the implementers. Who participates and what is included is leadership's prerogative.

The program review committee examined the enactment history of recent implementer bills. As the Table 18, below, shows, until 1999 bills to implement the budget were done more or less simultaneously with the passage of the budget. Since 1999, implementer bills have been adopted during special session by emergency certification “E-cert”). In recent years have been emergency certified and adopted by the legislature on the same day.

From a practical point of view, the sheer size and nature of the bills can be overwhelming. One of the major implementer bills in 2003 exceeded 250 pages in length, while another contained more than 100 pages. There is a concern that legislators cannot fully understand the content of implementers given the time constraints of the emergency certification process.

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**Table 18. Implementer Bills 1999-2003**

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<b>Implementer Bill Number</b>	<b>E-Cert Date</b>	<b>Senate Passed</b>	<b>House Passed</b>
PA 99-2 (HB 7501)	6/14/99	6/14/99	6/14/99
PA 99-1 (SB 2001)	6/14/99	6/14/99	6/14/99
PA 01-9 (HB 7507)	6/29/01	6/29/01	6/29/01
PA 01-4 (HB 7505)	6/29/01	6/29/01	6/29/01
PA 01-2 (HB 7502)	6/28/01	6/28/01	6/28/01
PA 03-3 (SB 2001)	8/16/03	8/16/03	8/16/03
PA 03-4 (HB 6805)	8/16/03	8/16/03	8/16/03
PA 03-5 (SB 2002)	8/16/03	8/16/03	8/16/03
PA 03-6 (HB 6806)	8/16/03	8/16/03	8/16/03

Source: LPR&IC analysis

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The joint rules of the General Assembly and state law require “regular” bills to be printed and upon the desks of the members at least two legislative days prior to its final passage.<sup>21</sup> However, the rules and state law allow the president pro tempore of the Senate and the House speaker to certify, in writing, the facts which in their opinion necessitate an immediate vote on a bill. When a bill receives emergency certification, the rules applicable to regular bills may be suspended.

Presumably, the time on the legislators’ desks is to provide examination and contemplation of bills. Given the potential policy impact implementers may contain, a reasonable amount of time for review should be allowed. These proposals should be carefully studied to accurately assess any budget and policy implications. **Therefore, the program review committee recommends implementer bills be available a minimum of 72 hours prior to a vote by the first chamber to consider the bill.**

Committee staff selected one of the 2003 implementer bills to determine to what extent its provisions made an impact on policy that had not been subject to the regular legislative process through public hearings or consideration by a substantive legislative committee.

The 2003 public health/human services implementer contains 95 sections.<sup>22</sup> Many of the provisions originated in the governor’s recommended budget. As Figure 4 shows, the Appropriations committee

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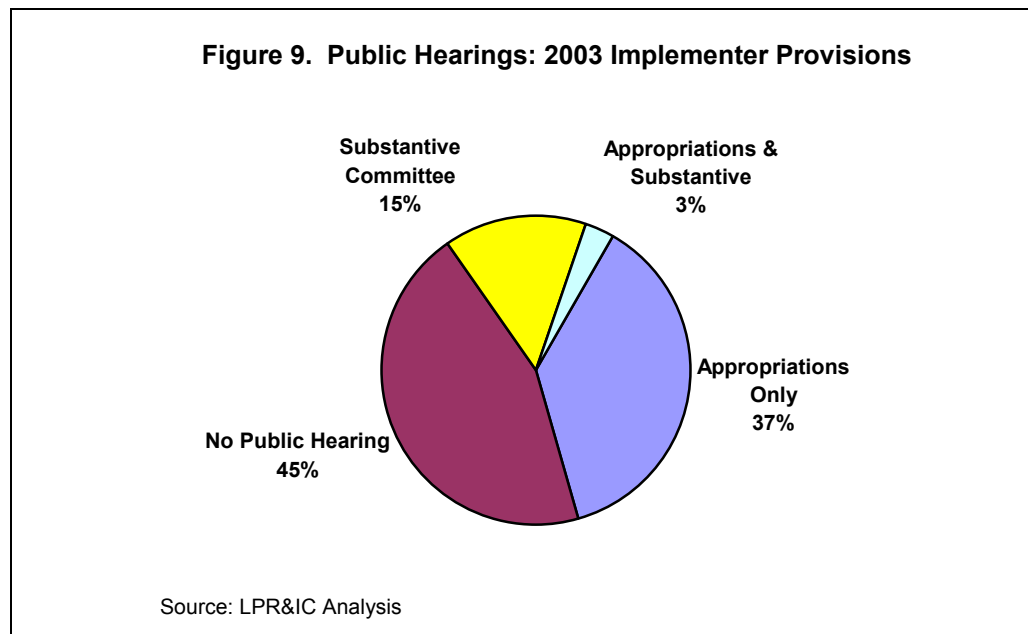
<sup>21</sup> Joint Rules 17(d) and C.G.S. §2-26

<sup>22</sup> Public Act 03-03 (Senate Bill 2001), “An Act Concerning Public Health, Human Services and Other Miscellaneous Implementer Provisions”

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formally considered close to 40 percent of all of the implementer sections during the regular session, almost all of which were from the governor's bill. It is important to note that the committees of cognizance held informational hearings on many of the governor's proposals even though they did not have the provisions formally before them.

Fifteen percent of the implementer provisions appear to have been formally contemplated in a subject matter committee public hearing during the regular session. Only three percent of the implementer provisions were considered both by Appropriations and the substantive committee. The remaining 45 percent did not appear to have a public hearing or any committee action.



*The number of implementer provisions that were never considered in committee during the regular session seems to undermine the purpose of the committee process.* This was a frequently referenced theme in program review staff interviews with legislators of both parties. It appears to be a common belief that there has been a breakdown of the committee process by allowing decisions to be made by others at different points in the legislative process. Many believe this is occurring at all levels - the committees of cognizance, the subcommittees of Appropriations, and the full Appropriations committee.

There are many theories as to why this occurs. Some believe the committee erosion is a byproduct of legislators thinking primarily of the interests of their districts and not visualizing the big picture and the best

interests of the state. This is intensified when fewer state resources are available for legislators to ensure their towns get what they need and want. A few blame the “back room” negotiations and promises of budget items that are sometimes not honored. Others speculate the breakdown is the result of legislators being less issue-oriented and more guided by re-election. Others note it can be easier to abdicate authority and later blame the one who made the decision and not be held accountable for an unpopular policy.

Evidence of committee breakdown is hard to document. The fact the legislature has not adopted a biennial budget within the regular session timeframe may be viewed as a breakdown of the committee process. Better evidence may be the scope of decisions being made during the implementer process. However, the program review committee believes just the perception of a process breakdown is a matter of concern.

The committee process is the primary opportunity for public participation in budget decision making. The perception that the process is somehow weak, flawed, or even ignored damages the legislature’s integrity. In addition, the perception may influence a participant’s behavior to resort to undesirable strategies and tactics. These behaviors may eventually convert the perception to a reality.

*Reduced review time and the broad scope and size of implementer bills limit the ability of individual legislators and the public to understand the implications of the provisions of the bills. The current emergency certification process allows no public hearing, no review by committees of cognizance, and limited input from the rank and file.*

Understandably, there is a desire or sometimes a need to group provisions together to ensure negotiated items do not fail. However, expediency should be secondary to a fuller understanding of direct and indirect effects. The goal should be to eliminate obstacles to legislators’ understanding of what they are expected to vote on. This is particularly important now as policy decisions are increasingly subject to voter and judicial review.

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## **Performance Measurement**

Performance measurement is generally agreed to be an essential component of a sound budgeting process. Information on performance is critical to setting goals, planning activities, allocating resources, and keeping agencies accountable. According to the Government Finance Officers Association, when performance measurement is effective and thoroughly integrated into a government budgeting process:

- strategic planning is used to identify goals and objectives;
- budget decisions are based on results and outcomes directly linked to specific goals and objectives;
- performance measures are used to monitor results and outcomes; and
- actual and projected results are compared and the analysis is used to make needed adjustments.

As noted in earlier chapter, statutory mandates for performance measures linked to state budgeting have been in place in Connecticut for a number of years, but remain unimplemented. *The Office of Policy and Management has failed to comply with provisions enacted in 1992 that require it to develop and report on agency goals, objectives, and outcome measures. To date, the legislature has not called for any corrective action.*

Many individual members of the General Assembly, however, remain committed to the concept of performance measurement and performance based budgeting. Committee staff interviews with legislative leaders and fiscal committee members revealed a general frustration with the inability to link funding decisions to program results. In recent legislative sessions, there has been broad support for a variety of proposals aimed at integrating performance measurement, strategic planning, and budgeting.

At the committee's September 16, 2003, public hearing, the OPM secretary testified in support of building a performance measurement system outside of the budget process but aimed at improving spending decisions. The state comptroller also testified in support of performance budgeting at the hearing. She further noted development of a performance measurement system would be facilitated by the recent implementation of CORE-CT, a statewide, automated financial system. Additional phases of the CORE-CT system include a component for collecting and reporting performance-related information.

*A way to systematize the availability and use of performance data within the legislature was outlined in an earlier program review committee report (Performance Measurement, December 1999). The report called for the development of a performance measurement system and a means for monitoring state agency compliance with the following elements:*

- OPM develops a program for measuring agency performance and a schedule for phasing it in over three years.
- OPM ensures state agencies: develop strategic plans that include goals, objectives, and measurable performance



indicators; collect data on the indicators, and produce annual performance reports for the legislature.

- Legislative committees identify their performance measurement needs for agencies to include in their strategic plans; OPM ensures committees have access to agency performance data.
- The program review committee analyzes and comments on the agency performance reports and data; the reports and comments are forwarded to the relevant legislative committees.
- The state auditors check for compliance with strategic plan requirements when conducting agency audits.

**The program review committee believes the performance measurement system outlined in the committee's 1999 report remains a sound approach and recommends it be adopted with a starting date of 2006. It is further recommended the Office of Policy and Management pilot the system with the state's workforce development program in 2005.**

A bill to implement the performance measurement recommendation from the 1999 report was considered in the 2003 session. It received unanimous favorable reports from the Appropriations and Government Elections and Administration Committees. The major obstacle to its passage was the estimated cost for the new system. Given the state's current fiscal situation, resources remain an issue.

Establishing an effective performance measurement system requires an investment of time and money. The program review committee staff estimated the annual cost of the new staff and equipment within OPM and the auditor's office required to implement the system would be around \$500,000. (It is possible additional staff might not be required by the program review committee if the state sunset law is repealed.). By the 2006 start date for the system, the state's financial condition may have improved sufficiently to make funding less of an obstacle.

If it is determined to be too costly to pursue a statewide system in the near term, the committee believes efforts should still be made to institute it in phases. One of the reasons the recommendation includes a pilot program is to ensure OPM can begin testing the system on a small scale until more resources become available. The workforce development program is proposed as the pilot based on the results of the case study the committee staff conducted as part of the budget study. The case study, which examined issues related to implication of performance budgeting, is described in detail in Appendix B.

A performance measurement system very similar to the one recommended by the committee is in place in Virginia. The Virginia system started as a pilot program in the early 1990s and has evolved into a performance management system (called “Virginia Results”) that links strategic planning, performance measurement, program evaluation, and to some extent, performance budgeting. Performance measures, at one time included in the state budget document, are now part of a comprehensive web-based information system that provides detailed outcome information by agency.

According the Joint Legislative Audit and Review Commission (JLARC), Virginia’s legislative oversight office, program and agency performance measures inform decision making at every level. Outcome information is included in agency budget requests, agencies have begun to systematically analyze outcome data, and information on performance is reviewed by legislative staff and summarized for legislative committees.

JLARC also reported while performance information is considered, there is little evidence it directly impacts budget decisions. Interest in using the data varies among key decision makers. However, the Virginia Results system is still viewed as a solid base for expanded use in management and budgeting decisions. A 2003 change adding the chairs of the fiscal committees to a new executive-legislative council that oversees the system is expected to increase legislative use of performance information.

## **Appendices**



## Appendix A

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### Glossary of Connecticut Budget Terms\*

Agency Program: an activity or group of activities with a common element. A program achieves the same goals or purposes, serves slightly different purposes but is performed by the same employees, or provides the same clients with similar services.

Allotment: the portion of an appropriation made available to cover expenses for a certain period or purpose.

Appropriation: an authorization by the General Assembly to make expenditures and incur liabilities for specific purposes. Agency funds are appropriated for two major objects, “Personal Services” and “Other Expenses,” and for specific purposes included under the category “Other Current Expenses,” which includes “Equipment” and “Fixed Charges”. See definitions of each major appropriation category for further detail.

Appropriations Act: the main legislation enacted by the General Assembly authorizing expenditures for the ensuing fiscal year. Other bills authorizing individual expenditures for certain purposes may be enacted, but usually do not involve significant funds.

Appropriations Committee: the committee of the General Assembly responsible for reviewing and making recommendations on all expenditure-related matters. Subject matter subcommittees examine agency budgets in detail with agency and budget office staff.

Bond Bill: the main legislation containing recommendations to the General Assembly from the Finance, Revenue and Bonding Committee for the financing of new and revised capital projects.

Bond Commission: the statutory body composed of six executive and four legislative members that determines which authorized capital projects will go forward through its power to allocate bond funds. The 10 commission members are: the governor, the treasurer, the comptroller, the attorney general, the secretary of the Office of Policy and Management, and the commissioner of administrative services plus the chairpersons and ranking members of the legislature’s Finance, Revenue and Bonding Committee.

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\* Definitions included in this glossary were compiled from the following sources: Legislative Office of Fiscal Analysis, *State Budget Process* (<http://cgalites/ofa/StateBudgetProcess.htm>) and *Budget Terminology* (<http://cgalites/ofa/Terminology.htm>); Governor’s Budget FY 2003-FY 2005 Biennium, *Glossary of Budgeting Terms Used in Part 2: Budget-in-Detail*.

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Budget: an estimate of proposed expenditures for a given period or purpose and the means of financing them, as expressed in appropriation and revenue acts.

Budget Options: proposed adjustments to individual agency programs that result in significant increases or decreases to their current services or “present level” budget.

Budget Reserve Fund (Rainy Day Fund): a statutorily required fund used to finance a state operating deficit at the end of a fiscal year. It consists of surplus funds from the operations of the General Fund (up to a total of ten percent of the General Fund).

Capital Budget: the portion of the state budget dealing with the estimates of proposed expenditures for land, nonstructural improvements to land, structural replacements and major improvements, and the means of financing them (i.e., normally bond funds paid off over a 20-year period).

Carry Forward: appropriated amounts an agency did not spend within the fiscal year that are allowed to be expended (“carried forward”) into the next fiscal year. The purposes and amounts of carry forward funding are specified in statute or other legislation.

Comptroller: the state’s official bookkeeper. Under the state constitution, authority to prescribe the mode of keeping and rendering all public accounts is vested in the Office of the State Comptroller. Financial activities of state agencies are recorded centrally in the comptroller’s office and the comptroller is responsible for producing and distributing monthly financial reports as well as an annual report on the state’s revenue, expenditures, and related information.

Current Services (“Present Level” Budget): the funding amount required to provide in the succeeding fiscal year the same services as in the current fiscal year plus any scheduled or required changes (e.g., updates for inflation or annualization of partial year costs, projected caseload increases or decreases, completion of projects, scheduled openings of new facilities, collective bargaining increases, or costs mandated by statute or court order).

Deficiency Appropriation: an additional (supplemental) appropriation made for an agency based on a need for increased funding during a fiscal year.

Deficit: the excess of a fund’s liabilities and reserves over its assets or the excess of the obligations, reserves, and unencumbered appropriations of a fund over its resources.

Expenses: the costs of operating maintenance, interest, and other current expenditures for which no permanent or subsequently convertible value is received.

Equipment: the appropriations category under “Other Current Expenses” for purchase of all items of equipment (e.g., machinery, tools, furniture, vehicles, various educational, medical, telecommunications, data processing apparatus) with a value over \$1,000 and useful life of more than one year.

Federal Grants: funds made available to the state by the federal government to encourage specific programs or projects or to reimburse specific state expenditures.

Finance Advisory Committee: a joint legislative-executive body responsible for approving transfers of appropriated funding between accounts within an agency. The committee is composed of the governor, lieutenant governor, treasurer, comptroller, and two Senate and three House members of the Appropriations Committee.

Finance, Revenue and Bonding Committee: the committee of the General Assembly with cognizance of all matters relating to finance, revenue, capital bonding, and taxation and of all bills on such matters favorably reported by any other committee.

Fiscal Note: a brief statement of costs or revenue impact, based on the best available information, prepared by the Office of Fiscal Analysis for certain types of proposed legislation (i.e., favorably reported bills and amendments).

Fiscal Year: the 12-month period from July 1 through June 30, at the end of which the state closes its books in order to determine its financial condition and the results of its operations.

Fixed Charges (Grants): the appropriation category under Other Current Expenses representing payments made to institutions, agencies, individuals, or undertakings that may or may not be under direct state control. Fixed charges are not part of an agency's operating budget. The two main categories are:

*Payments to Local Government* (e.g., direct payments to towns for specified purpose or reimbursement of expenses already incurred such as grants for local educational costs); and

*Payments to Other Than Local Government* (e.g., assistance payments to individuals such as Medicaid or payments for contractual services provided to clients by non profit entities).

General Fund (GF): the main operating fund of state government that finances ordinary, everyday expenses of the state and purposes for which special funds (e.g., see Transportation Fund) have not been established. It is funded by taxes, federal aid, and revenues from licenses, permits and other fees. The fund operates principally under a budget plan adopted by the General Assembly.

Governor's Budget: the document used to present the comprehensive financial program, including spending and revenue proposals, recommended to the General Assembly by the governor.

Lapse: appropriated amounts an agency does not or cannot spend by the end of the fiscal year that are not carried forward into the next fiscal year.

Office of Fiscal Analysis (OFA): the General Assembly's non partisan professional budget office. OFA, which supports the legislature in both budget formulation and execution, analyzes the governor's budget recommendations, determines fiscal impact of legislation by completing

fiscal notes on bills and amendments, and responds to fiscal information requests from individual members and committees.

Office of Policy and Management (OPM): the executive branch budget office responsible for assisting the governor in developing the recommended budget and executing the final budget.

Other Expenses (OE): the appropriations category used for the following types of agency operating expenses as well as miscellaneous purposes not covered under another appropriation:

Contractual Services (i.e., compensation for services secured by contract);

Commodities (i.e., supplies, materials, and equipment not normally regarded as capital items); and

Sundry Charges (e.g., expenses not assignable to standard accounts such as rewards, payments to lottery agents, grants to students).

Other Current Expenses (OCE): appropriations authorized for specific purposes within the categories of personal services, other expenses, equipment or fixed charges that can only be expended for the authorized purpose.

Personal Services (PS): the appropriations category reflecting compensation for the services of state officials and permanent full-time, part-time and/or temporary employees. Personal Services includes the following items: regular salaries, overtime, and payments for vacation, sick leave, longevity, hazardous duty, and shift differential. All expenses chargeable to this funding object must be related to a state payroll.

Program Budget: an estimate of proposed expenditures expressed as major programs (or sub-programs) of budgeted agencies and the means of financing them. Program budget documents include program objectives, program descriptions, performance measures, and explanations of significant program changes requested and recommended.

Program (Outcome) Measure: measures quantifying key aspects of program performance such as workload, output, outcomes, client/employee ratios, or response times.

Revenue: additions to cash or current assets that neither increase any liability or reserve nor represent the recovery of an expenditure.

Surplus: the excess of the assets of a fund over its liabilities, or the excess of its resources over its obligations and reserves.

Transportation Fund: the separate state fund used to finance the ordinary, everyday operations of the state Department of Transportation (DOT) plus the debt service on bonds issued for transportation purposes, fringe benefits for DOT employees, and other related costs.

Turnover: a reduction made in the personal services account of an agency to reflect savings based on the loss of employees through attrition (retirement, quitting) and subsequent delays in hiring or the hiring of new employees at lower salaries.



### **Workforce Development: Case Study Results**

As part of the budget process study, the program review committee examined issues related to performance budgeting implementation using workforce development programs as a case study. Case study findings along with background information on the state workforce development system are presented below.

#### ***Background***

Connecticut's current workforce development system evolved from federal job training programs established in the 1960s for dislocated and disadvantaged workers. At present, the system includes federal, state, and local programs aimed at helping people find employment and ensuring employers have a skilled workforce. The four main components of the workforce development system are:

- employment-oriented programs of the Connecticut Department of Labor (DOL);
- post-secondary education programs of the state's higher education system;
- adult education programs delivered through local boards of education; and
- vocational rehabilitation programs, primarily those operated by the state Bureau of Rehabilitation Services and the Board of Education and Services for the Blind.

Major workforce development activities include job search assistance, job training and employment-related rehabilitation services, social services, and support services. Target populations of the system are both adult and youth workers who are dislocated, disadvantaged, unemployed or have special needs.

Overall, federal laws and funding dictate most of the state's workforce development activities and organization. The main federal mandates are contained in the Workforce Investment Act (WIA) of 1998, which Connecticut incorporated into state law in 1999. Under WIA, states must:

- establish a state workforce development board and local area boards, which must contain youth councils;

- submit a five-year plan to the U.S. labor department detailing how services are to be provided to target populations; and
- negotiate state performance standards with the department before the plan is submitted.

The state boards must coordinate all workforce programs funded by the federal labor department including unemployment insurance and welfare-to-work programs, as well as federal employment and training programs administered by the U.S. education and housing and urban development departments, and collaborate with other relevant federal programs.

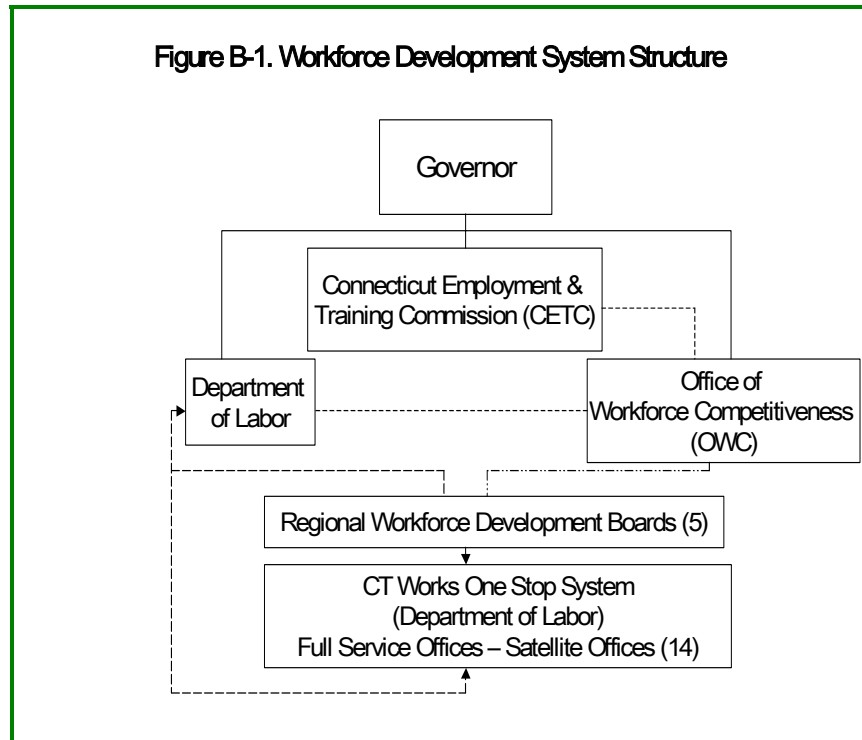
Local workforce boards, which serve local areas designated by the governor, must:

- establish and submit to the governor a five-year plan that contains local performance standards negotiated with the governor; and
- provide services through one-stop centers and employment and training providers.

Local boards are, for the most part, prohibited from directly providing training services. The providers they contract with must meet certain standards and eligibility requirements, and all clients must receive services through a voucher system.

In each local area there must be a one-stop center to provide core services (e.g., outreach, eligibility determination, assessment, case management, job search and placement) and access to training services. The work preparation and career development services provided by the centers must be available to all state citizens.

**Role and responsibilities.** The structure of the workforce development system in Connecticut is shown in Figure B-1. As the figure indicates, the state labor department and the Office of Workforce Competitiveness (OWC) have primary responsibility for job training and workforce development programs in Connecticut. DOL administers federal and state employment service, unemployment insurance, and workforce development programs, while OWC is responsible for coordinating the workforce development activities of all state agencies. OWC also provides staff support to the state development workforce board, the Connecticut Employment and Training Commission (CETC).



CETC is responsible for overseeing and improving the coordination of all education, employment, and training programs in the state in addition to serving as the state board required under WIA. Annually, the commission must make recommendations to the governor and legislature about WIA funding appropriations. It is also required to develop and update the state's workforce development plan that includes state performance measures. Under state law, the commission is also required to annually report results regarding employment outcomes of all employment and training programs included in its statewide program inventory.

The state's regional workforce development boards coordinate efforts at the local level. Each board is responsible for setting policy, conducting strategic planning, coordinating service delivery, and administering one-stop operations within its local area. The number of workforce development areas and corresponding regional boards was reduced from eight to five effective July 1, 2003.

Connecticut's one-stop centers, known as *Connecticut Works (CTWorks)* centers, offer job seekers counseling, skills training, and job search assistance and provide employers with recruiting, job training, and related support. At present, there are 14 centers operating throughout the state under the direction of the regional boards.

**Funding.** To keep the scope of the case study manageable, program review committee focused its review on the funding and performance measures for the workforce development system's employment-related

programs, which are administered or provided by the state labor department. The post-secondary and adult education programs and vocational rehabilitations programs included in the system and monitored by CETC, therefore, were not part of the case study analysis.

Funding information for the employment-related workforce development programs in FY 04 is summarized in Table B-1. The table shows over half (56 percent) of program funding is from federal sources, which include: current year WIA grants (except for possible incentive awards that are yet to be determined); WIA funding carried forward from FY 03; federal welfare-to-work money; and federal faith based funding. About 44 percent is state funding appropriated for OWC administrative and program costs and the Jobs First program (state employment services for welfare recipients).

**Table B-1. Workforce Development Funding for Employment-Oriented Programs: FY 04 Distribution (dollars in millions)**

	Total	Pct.	Source of Funding	
			% Fed.	% State
<b>Regional Bds.</b>	\$28.73	62%	65%	35%
<b>Dept. of Labor</b>	\$11.07	24%	62%	38%
<b>OWC</b>	\$ 3.72	8%	0%	100%
<b>Other*</b>	\$ 3.03	7%	13%	87%
<b>Total</b>	\$46.56	100%	56%	44%

\* Other includes interagency transfers (e.g., certain Department of Social Service funding) and funding for certain contractors (e.g., community colleges)

Sources of data: Connecticut Dept. of Labor and OFA

The bulk of the statewide workforce development program funds (almost \$29 million) was provided to regional workforce boards. Separately, the regional boards also receive funding directly from the federal government (e.g., through competitive grants for workforce development activities) as well as from state agencies other than DOL and private donations. In FY 03, this additional funding at the board level totaled approximately \$18 million.

**Performance measures.** Performance measurement is a critical element of the workforce development programs. Under WIA, states and local area boards are required to track and report on a number of performance indicators each year. The core indicators are employment outcomes that include: the number of adults and youth obtaining an unsubsidized job; the number keeping a job for six months; the amount of earnings after six months of working; and the number either obtaining a job or entering a job training or educational program and receiving a credential (e.g., professional license, high school diploma, certification).

CETC's annual "report card" on all state employment and training program results highlights similar performance measures (i.e., number who completed training, entered employment, and retained employment, as well as weekly wages at placement and wage change pre- and post-program). Since the federal law requires customer satisfaction be measured, CETC has also commissioned surveys of both participants and employers regarding satisfaction with one-stop services.

As noted above, under the WIA program, states and the local boards negotiate their expected performance standards with the federal labor department and must report annually on their progress. If standards are not met over time, federal funding can be reduced. Conversely, if a state exceeds its negotiated level of performance, it is eligible for additional WIA incentive monies. However, potential reductions are limited (e.g., up to 5 percent of an allocation) and state incentive grants are relatively small (e.g., Connecticut received \$361,000 in FY 03).

### ***Findings***

Based on its review of the structure and funding for employment-related workforce development programs, the program review committee found *the state's workforce development system encompasses many elements critical for performance budgeting*. The state has a well-developed strategic planning process for workforce development programs that provides for participation by all stakeholders. Clear goals and relevant and realistic measures of performance have been established for the programs. Performance data are collected, widely reported, and are generally of good quality.

Measures of performance are regularly reviewed by CETC and the local boards; further, they are used to track progress toward goals, identify areas in need of improvement, and set priorities. Through the state commission and the Office of Workforce Competitiveness, there is a formal mechanism for coordinating workforce development programs across state agencies and levels of government and monitoring results statewide.

The effectiveness of the workforce development performance measurement system is the result of federal and state mandates, the state commission's long-term commitment to full implementation of the system, and active oversight by OWC. Federal funding is provided for the staffing and technology needed to build and maintain performance information systems. Performance measurement matters are the sole responsibility of one of the CETC subcommittees.

At the same time, the program review committee found *many of the obstacles to implementation of performance budgeting cited by experts are also present within the workforce development system*. Most of the public

funding for workforce development programs is formula-based rather than discretionary, and a large portion of Connecticut's funding is subject to federal constraints. Without a federal initiative to allocate more workforce development funds on a performance basis, there is limited opportunity for the state to move in this direction.

Furthermore, while the workforce development performance measurement system is well developed, existing measures only partially capture the programs' goals. The indicators that are currently monitored focus on job placement, although CETC and the local boards are working on expanded indicators such as process measures related to timeliness, responsiveness to customer needs, coordination, and efficiency. Also, economic conditions have a strong impact on employment outcomes, which further complicates assessments of program results. Coming up with the right measures to accurately reflect a program's overall performance is a persistent challenge for performance-based budgeting models.

As noted above, performance is the basis for some incentive funding by the federal government now. CETC is also discussing possibilities for state incentive funding. For example, when the state's fiscal condition improves, funding could be made available for bonus grants to regional boards that achieve certain goals of the one-stop centers. The committee also found performance measures are considered by local boards during a number of funding decisions, such as when outside contractors are being selected. Performance measures are taken into account in funding decisions at the state level as well. CETC reviews various outcome data in developing the state plan and making recommendations regarding the allocation of federal funds.

Based on the results of the case study and the experience of other states in implementing performance budgeting, it appears the selective use of performance measures to guide funding decisions may be the most practical approach at this time. Clearly the most important thing is to have a system in place that makes good data on program results available for decision makers to consider during the budgeting process.

The program review committee believes the case study results can be instructive to OPM in developing the performance measurement system recommended in the previous section of this report. The main reason workforce development was recommended as a pilot project was its well-developed performance measurement process. A second phase of the project could go on to test options for performance budgeting within workforce development. OPM, for example, could pursue CETC's idea of providing state incentive funding for successful implementation of one-stop requirements once the state's financial condition improves.

**Agency Response:  
Office of Policy and Management**







STATE OF CONNECTICUT  
OFFICE OF POLICY AND MANAGEMENT

February 17, 2004

Carrie E. Vibert  
Acting Director  
Legislative Program Review and Investigations Committee  
State Capitol  
Room 506  
Hartford, CT 06106

Dear Ms. Vibert:

Thank you for the opportunity to comment on your report entitled The Connecticut Budget Process. This report is very thorough and well-researched. I commend you and your staff on its' quality and in fact have adopted or expanded upon a number of the recommendations made in it in the Governor's legislative package. In terms of the specific recommendations contained in the report, I would offer the following comments.

LPRIC Recommendations

1. **Maintain the 10% maximum balance for the Budget Reserve Fund until better information is available on what level is most appropriate.**

That the **minimum balance** should have been increased from 5% and 10% is a good start. To determine the most appropriate level, we should review the state's experience with recessions and calculate the percentage of the budget that would be needed to be available to weather the next recession considering our recent experience and projected experience. Factors such as the changing state economy, tax structure and behavior under the spending limit between measurement periods should be taken into account.

Equally important, however, is the commitment to replenish the Rainy Day Fund in the near future. One of the Governor's legislative proposals would mandate the transfer of \$50 million a year into the Rainy day Fund any time the balance drops below 5%, beginning in FY'06. This number would grow to \$100 million in FY'09. Passage of this legislation would demonstrate a commitment on the part of the Executive and Legislative branches to begin to infuse the fund with necessary revenues in order to be prepared for next downturn in the economy.

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[www.opm.state.ct.us](http://www.opm.state.ct.us)

**2. Make funding of the GAAP system a priority for the use of any future state surpluses.**

The GAAP system of accounting is being used by the Comptroller to report to external parties on the past year's fiscal experience. It is less important to employ GAAP to budgeting the state's financial resources. GAAP's major benefit is in outlining future assets and liabilities. The cost to the state would be real money now to comply with a new budgeting perspective, which does not enhance many public financial management goals such as reliability, accountability/ control, and comprehension to name a few.

The Office of Policy and Management does not believe that this recommendation should be made a priority at this time. Clearly, replenishing the Budget Reserve Fund and the judicious use of unbudgeted surplus for debt avoidance should be higher-level priorities. Once fiscal times improve, budgeting on a GAAP basis could be looked at again for its viability.

**3. Designate OPM as the single point of contact for federal revenue maximization. OPM, within available resources, should seek outside contractors to identify maximization opportunities.**

OPM is generally in support of this recommendation. The Governor has submitted proposed legislation that would establish a process for implementing this initiative. In order to be successful, it will be necessary to provide additional resources to this agency to accomplish these tasks. Most importantly, OPM does not believe that every federal dollar is worth pursuing but rather, that Connecticut should focus on those maximization opportunities that are most consistent with our programs, priorities and policies.

**4. Retain the Biennial Budget Cycle**

OPM supports the retention of the Biennial Budget Cycle including the analysis by the Office of Policy and Management and the Legislature regarding mid-year and partial year spending initiatives.

In addition the Governor has submitted a legislative proposal requiring that Legislative fiscal notes "clearly identify the cost and/or revenue impact to the state and municipalities in the current fiscal year and each of the next five succeeding fiscal years."

**5. Amend the statutes to require a joint informational meeting be held by the appropriations and finance committees each year by November 15 to consider the current and future balance of the state general budget.**

OPM endorses this recommendation and the Governor has submitted a legislative proposal on this subject. Page 137 of the Governor's Midterm Budget Adjustments outlines his proposal in detail.



- 6. Require by law that OFA prepare its budget book each year and make it available to the public within 60 days of final action on the current year's fiscal legislation. The book should include a concise summary and guide to key budget issues for use by the general public.**

OPM endorses the recommendation that the annual preparation of OFA's "budget book" become a statutory requirement. It serves as an agenda to implement the budget.

Although 60 days to produce the document may seem a great improvement over recent practice, it is still too long. State agencies and citizens need to refer to the legislative intent expressed in that document to begin the fiscal year and waiting until September means that one quarter of the fiscal year is almost over. It should not take 2 months to produce from the point of final decision if the process stays on schedule. It takes OPM approximately 2 weeks to produce a budget document after the Governor has made all of his decisions. OFA should also attempt to turn this around in 2 weeks.

- 7. Establish a special budget committee consisting of the majority and minority leadership of both chambers and the leadership of the appropriations and finance committees and require it to meet at least one week before the start of the regular session to: set spending targets for each major target area based on current and prospective economic conditions; and adopt an estimate of revenue available under the existing tax structure and under any proposed modifications.**

This recommendation naturally flows from recommendation 5. Both are intended to promote a longer-term perspective and to build more structure into what is at times a very unstructured process. It is always a good idea to begin the budget process with an understanding of how much income that you expect the revenue structure to make available for spending and to determine what your spending priorities are before you approach the task of budgeting. Having said this, however, does not make it easily achievable. Most often, the consensus needed to develop a guiding set of policy priorities does not exist at the start of the process. However, it may be possible to forge some early consensus regarding the general framework within which the budget must operate.

- 8. Institute a provision requiring the budget to be enacted a week before the end of the regular session. If this does not occur, all pending legislation shall die and only the budget may be considered.**

OPM endorses this recommendation and the Governor has submitted this as a legislative proposal. We believe that passage of the budget is the penultimate task of the legislature in each session.

**9. Require implementer bills be available a minimum of 72 hours prior to a vote by the first chamber to consider the bill.**

This is a recommendation that OPM could support. However, it should be noted that this requirement assumes that many of the other structural changes have occurred and the process has matured to the point where this is practical.

**10. Adopt the performance measurement system outlined in the committee's 1999 report with a starting date of 2006. The OPM should pilot the system with the state's workforce development program in 2005.**

The Executive branch has been criticized in this report for failing to comply with provisions of the performance budgeting legislation. It should be noted that improvements could be made to the measurement and reporting of the performance of state agencies, albeit at a price. It has been OPM's position that performance measures can be effective internal management tools but are of limited value in the budget deliberation process, which relies upon such quantitative data only sporadically.

**Performance measures should be utilized outside of the budget adoption process to frame the debate during the budget session where line items are set. Putting performance measures in the budget as a direct tool would not work.**

However, more importantly it should be strongly noted that there already are many agencies that report on their performance and that the OPM actively correlates the Governor's budget recommendations to the agencies projected performance so that the legislature and agency understands what operating efficiency and results are expected with the level of financial support being recommended. The significant disconnect that occurs is that the legislature fails to close this loop by using these measures and reporting the expected operating efficiency and results it finally intends the agencies to achieve with the resources that it appropriates to them.

Investing scarce resources into creating and maintaining a system designed to measure and report performance is predicated upon a strong commitment of all the decision-makers involved to utilize this information in the resource allocation process. I believe that the resources required to do this are significant and do not believe that there is a consensus about committing to this type of process.

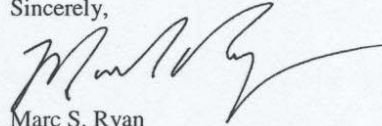


One final comment on Performance Budgeting. It's interesting to note that Virginia - long considered the model for this - does not use performance data directly in budget decision-making.

Lastly, on the more technical side, on page 61, in the third paragraph entitled "Budget techniques" there appears to be a note left in to the drafters. Also on page 61, in the last paragraph, there is an inaccurate description of how carry-forward dollars would impact the spending cap calculation. Carry-forward dollars do not change the appropriation amount and therefore still count against the year in which they were appropriated for purposes of calculating the spending cap.

Thank you for affording my office the opportunity to comment on this report. As I said earlier, it is very well done. I hope that you find these comments helpful and would certainly be willing to discuss the report with you in the future.

Sincerely,

A handwritten signature in black ink, appearing to read "Marc S. Ryan", with a long, sweeping horizontal line extending to the right.

Marc S. Ryan  
Secretary